

2010-2011 UPDATE COURSE

SECTION THREE

RESPA REFORM – 2010 THE NEW GOOD FAITH ESTIMATE AND HUD-1 FORMS

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Learning Objective: Upon completing this Section, licensees should have a good understanding of the changes in the Good Faith Estimate and HUD-1 Settlement Statement forms, the reasons underlying these changes, proper completion of the revised HUD-1 form, and a broker's responsibilities regarding closing statements.

NOTE: *Classroom instruction will briefly address the RESPA changes in general and the new GFE form. Details regarding these matters are provided in these materials for brokers to read and refer to outside of class. Emphasis in class will be placed on the revisions to the HUD-1 form, completion of the form's revised sections and a broker's responsibilities relating to closing statements.*

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

The **Real Estate Settlement Procedures Act (RESPA)** was enacted by Congress to help protect buyers when they are obtaining a mortgage loan and closing on a residential real estate transaction. Originally passed in 1974, RESPA has been amended several times. The law is administered by the Department of Housing and Urban Development (HUD), which adopted comprehensive rules implementing the law. ***Substantial amendments to these rules were implemented by HUD effective January 1, 2010*** and are discussed in this section. HUD's RESPA rules are commonly referred to as "*Regulation X*." The RESPA statute, rules, forms and a multitude of other RESPA-related information may be found on HUD's website at www.hud.gov/respa.

RESPA's Purpose

RESPA's goal is to protect consumers, especially borrowers of mortgage loans, in residential real estate transactions. The law and implementing regulations attempt to accomplish this goal by requiring substantial disclosures to borrowers and otherwise regulating lending and closing practices.

Applicability of Law

RESPA applies to **residential** transactions involving a federally related mortgage loan. *A "federally related mortgage loan" is any loan insured, regulated or guaranteed by the federal government or which will be sold in the secondary mortgage market, which loan is secured by a lien on real property containing an owner-occupied residential 1-4 family dwelling or real property on which such a dwelling (including a manufactured home) will be constructed or placed within two years of settlement.* Although there are a few exemptions (business, commercial or agricultural loans, loans on property of 25 acres or more, etc.), *the law applies to virtually all mortgage loans secured by residential **owner-occupied** 1-4 family dwellings made by institutional lenders*, including home purchase loans, home improvement loans, home equity loans, reverse mortgages, and refinancing loans. Note that RESPA does *not* apply to loans for a commercial, agricultural or business purpose, the latter of which includes loans secured by residential rental or investment properties. Such properties are considered to be for a "business" purpose and presumably would not be owner-occupied.

The Need for RESPA Reform

After years of conducting comprehensive studies of the mortgage lending and loan closing processes, HUD concluded there were substantial problems with various mortgage lending practices followed by some lenders that were believed to discourage loan shopping by borrowers and to unnecessarily increase loan origination and closing costs for many borrowers.

Objectionable Lending Practices Prior to 2010

- Charging higher than warranted loan origination fees and charges for lender required services provided by lender-selected or lender-recommended third party service providers without borrowers realizing they were paying non-competitive fees.

- Issuing good faith estimates (GFEs) in a variety of formats, typically containing a long list of confusing specific charges, that made it more difficult for borrowers to compare the costs of loans from different lenders.
- Requiring potential borrowers to pay a substantial loan application fee before issuing a GFE, which discouraged borrowers from shopping around for the best loan rates and fees.
- Including on GFEs estimated closing costs that frequently were unreliable or incomplete, resulting in borrowers being surprised at closing when actual charges were significantly higher than those shown on the GFE.
- Paying an extra bonus or incentive fee (called a “yield spread premium”) to mortgage brokers for making loans at an interest rate higher than the rate the borrowers were eligible to obtain in order to increase profits for the lender and subsequent investors. These incentive fees were not separately identified and were passed on to the borrowers who often did not understand they were being charged not only an above-market interest rate, but also an excessive loan origination charge.

RESPA Rule Revisions Effective January 1, 2010

To address the problems described above, **HUD adopted major revisions to its RESPA rules effective January 1, 2010.** The revised RESPA rules *for the first time* now require loan originators (lenders or mortgage brokers) to use a new **standardized Good Faith Estimate (GFE) form**, define when the GFE must be issued and what initial fees may be charged prior to GFE issuance, and provide a revised standardized *HUD-1 Settlement Statement form* that added a third page to be used to compare the actual closing fees with the charges stated on the GFE. The recent RESPA revisions seek to achieve the following:

Main Purposes of RESPA Rule Revisions

- By improving and standardizing the GFE, provide timely and effective disclosure of settlement costs to consumers, protect them from unnecessarily high settlement costs and better enable them to shop for a loan from various lenders;
- Clearly disclose yield spread premiums and mandate that borrowers receive a full credit against the loan origination costs for any such charges;
- Facilitate comparison of the GFE charges to the actual HUD-1 costs; and
- Strengthen the prohibition against lenders requiring consumers to use affiliated businesses.

Information Booklet for Homebuyers/Borrowers

The loan originator (lender or mortgage broker) continues to be required to provide a borrower with a copy of a HUD-prescribed information booklet. The booklet, ***Shopping for Your Home Loan***, must be provided to the loan applicant in person or mailed to the loan applicant within three business days following receipt of the loan application, unless the loan is

denied within that three day period or the borrower withdraws the application. The information booklet, formerly entitled *Buying Your Home: Settlement Costs and Helpful Information*, was substantially revised effective January 1, 2010 to reflect the major changes in lending and closing practices required by RESPA rule revisions effective the same date.

The information booklet addresses shopping for a house, shopping for a loan, the Good Faith Estimate (GFE) form (with sample), shopping for settlement services, the settlement process, the HUD-1 Settlement Statement form (with sample) and other matters related to the residential lending and closing processes. The booklet is very informative and real estate brokers are urged to advise potential buyers to study the booklet so they can better understand the buying process and especially the GFE and HUD-1 forms.

THE GOOD FAITH ESTIMATE

General Information

The good news for real estate brokers is that the Good Faith Estimate (hereafter, GFE) basically involves only the loan originator and the borrower. *It is **not** the responsibility of the real estate broker nor the settlement agent to insure that the GFE was timely and correctly provided.* Thus, while lenders and mortgage brokers may be struggling to understand and implement the new GFE requirements, it is their issue with which to wrestle. However, licensees, particularly those representing buyers, should have some understanding of the fundamental requirements and to that end, this summary is provided.

When must a GFE be issued?

A GFE must be provided to all loan applicants no later than **three business days** after a mortgage broker or lender either has received a loan application *or* obtains certain specified information that enables them to issue a meaningful GFE. However, if the loan originator determines within that initial three day period that it will not extend a loan to the borrower or if the borrower notifies the loan originator that they do not wish to proceed with that lender/originator, then the originator is not required to issue a GFE. If a *mortgage broker* issues the GFE, the lender is nonetheless responsible for it.

What is a “loan application?”

There are six pieces of information about a borrower that, once received by a mortgage broker or lender, are sufficient to constitute a “loan application” for the purpose of triggering GFE issuance, regardless of whether a formal application is submitted. This information includes:

- the applicant’s name
- the applicant’s monthly income
- the applicant’s social security number (to obtain a credit report)
- the property address
- the estimated value of the property
- the requested loan amount

The lender may also request other information it deems necessary, such as the applicant's birthdate, the type of property involved, any particular lending program the borrower wants and whether it will be owner-occupied. *However, the lender may **not** at this stage insist on collecting detailed supplemental documentation such as verification of the borrower's alleged income.* Once the mortgage broker or lender has obtained the foregoing information, then it must issue a GFE within three business days unless it decides within that period to deny the "application" or the borrower withdraws. The GFE may be personally delivered to the borrower, or mailed, or sent by fax or email if the borrower consents.

Initial Fee Charged to Borrower

The RESPA rules now *restrict the fee that may be charged to a borrower prior to issuance of a GFE to the cost of obtaining a credit report.* This was an important change intended to encourage loan shopping by borrowers using GFEs obtained from different lenders.

What the GFE Does

The GFE *provides the borrower with an accurate estimate of all settlement costs.* The settlement cost estimates quoted in the GFE must be available to the borrower for at least 10 business days. *If the borrower pursues completion of the loan application within 10 business days, the GFE becomes binding with regard to the settlement costs stated,* subject to the permitted tolerances (discussed subsequently) and assuming that no subsequent GFE is issued due to changed circumstances that allow the lender to issue a new GFE. Understand, however, that the quoted interest rate and the stated monthly principal and interest payment typically will expire less than 24 hours after GFE issuance unless the borrower locks the rate. (See points 1 and 3 on page 1 of the GFE.)

By having a binding effect on the lender and restricting increases in the settlement charges stated on the GFE at the actual settlement, the GFE helps borrowers to more accurately assess how much money they will need to close. *Perhaps most importantly, the standardized GFE format and the restriction on the amount lenders can charge prior to GFE issuance enable borrowers to use the GFE to more effectively shop for the best loan.*

The GFE is **not** a commitment to make a loan and is **not** an interest rate lock. *If an interest rate is not locked or if the rate lock period has expired, the GFE is no longer binding with regard to those charges that are tied directly to the interest rate quoted.* An interest rate lock (which often is valid for 30 days or longer) is provided to borrowers separately from the GFE, as is a loan commitment upon approval of the borrower's loan by underwriters.

Major GFE Features and Disclosures

*The reader is referred to the **Sample GFE** included at the end of this section. A few of the key GFE features and disclosures are discussed below.*

Page 1 of GFE

The first page of the three-page GFE shows the following:

- Name and address of the loan originator and the borrower, and the date the GFE is issued.

- Important Dates: Date on which the stated interest rate expires; date through which the estimate of settlement charges is valid; interest rate lock period (after rate is locked); and days before settlement the rate must be locked.
- Summary of borrower's loan terms and escrow account information.
- Summary of borrower's settlement charges, including the borrower's total estimated settlement charges, separated into A) adjusted origination charges and B) charges for all other settlement services. These charges are further itemized on page 2 of the GFE.

Page 2 of GFE

The second page provides the detailed estimate of settlement charges broken into two parts:

Part A – Loan Origination Charges

Item #1 – Our Origination Charge. All charges for *all* loan originators (lenders and mortgage brokers) must appear in Item 1, except for any charge or credit to the borrower for a specific interest rate. Every charge by all loan originators must be included in this lump sum fee. This includes such charges as the origination fee, application fee, processing/administrative fee, underwriting fee, mortgage broker charges, in-house appraisal fee, commitment fee, courier fees, etc.; however, these charges are NOT specifically itemized on the GFE. If the borrower wants an itemization, he or she should ask the lender. The single charge for loan origination gives the borrower a better basis for comparing the total charges of various lenders.

Item #2 – Your Credit or Charge (Points) for the Specific Interest Rate Chosen. This shows any adjustments to the loan origination charges quoted in Item #1 for *either* a **yield spread premium** paid by the lender to a mortgage broker who originates the loan at an above-market interest rate (a **credit** to the borrower against the fee quoted in Item #1) *or* a **discount fee (“discount points”)** paid by the borrower to obtain a below-market interest rate (a **charge** to the borrower).

Line A – Your Adjusted Origination Charge. This is the amount in Item #1 adjusted by the amount in Item #2. If there are no adjustments for a yield spread premium or discount points in Item #2, then the charge quoted in Item #1 and on Line A will be the same.

ALL loan origination charges of the lender (and any loan originator other than the lender) must be shown in Part A and the cost to the borrower as stated in the adjusted origination charge MAY NOT INCREASE after the GFE is issued (unless there is a “change in circumstances”).

Part B – Charges for Other Settlement Services

Item #3 – Required Services Selected by the Lender. All services the lender requires to be performed *utilizing providers the lender selects* are listed along with the charge for each and the total cost. Common examples of lender selected services are appraisal, credit report fee, tax service fee, flood certification fee and up-front mortgage insurance premium.

Items #4, #6 and #11 – Services for Which the Borrower May Be Allowed to Shop. If the borrower is permitted to shop for the services in Items #4 and #6 (as is typically the case in North Carolina), the lender must provide the borrower with a written list of providers on a separate document at the time the GFE is issued, but the borrower may choose a provider not on the lender's list. If the borrower selects providers recommended by the lender, then the aggregate cost of those services may not exceed the amount stated on the GFE by more than 10%; otherwise, there is a tolerance violation. However, if the borrower chooses a provider not on the lender's list, then the lender has no liability for the fee charged by the provider.

- **Item #4 – Title Services and Lender's Title Insurance** are *required* services. Included are expenses for the *lender's* title insurance premium as well as the fee incurred for the actual title search and title opinion as well as all fees for handling the settlement (i.e., the closing attorney's fee in North Carolina).
- **Item #6 – Required Services That You Can Shop For** lists other *required* services for which the borrower may select the provider (common examples are pest inspection and survey).
- **Item #11 – Homeowner's Insurance.** This is *required* by the lender, but the borrower is permitted to select the insurance company.

Item #5 – Owner's Title Insurance is *optional* for the borrower – i.e., not required by the lender – but it is highly recommended.

Item #7 – Government Recording Charges is self-explanatory.

Item #8 – Transfer Taxes. This line usually will be blank in North Carolina because any transfer taxes (e.g., excise tax) typically are paid by the *seller* pursuant to statute, absent a contrary provision in the sales contract.

Item #9 Initial Deposit for Your Escrow Account and **Item #10 Daily Interest Charges** are self explanatory.

The **TOTAL ESTIMATED SETTLEMENT CHARGES** (totals from Lines A & B) are shown at the bottom of page 2.

Page 3 of GFE

The RESPA rules now prescribe that certain fees quoted on the GFE may not increase at all at settlement (i.e., on the HUD-1 form), certain fees may increase within a set limit, and certain fees may change by any amount. There are now three different “tolerance categories” into which the various cost estimates reflected on the GFE will fall. These different categories are described at the top of page 3 of the GFE and are summarized below.

Fee Tolerance Categories

Zero Tolerance. These are fees that can not increase in the slightest; in other words, the *actual costs reflected on the HUD-1 must be equal to or less than the estimates stated in the GFE.* Otherwise, there is a “tolerance violation.” These charges include all **lender origination charges**. These costs are totally within the control of the lender and are

known to it from the outset and thus are not permitted to increase. [The GFE also lists in this category any **transfer taxes to be paid by the borrower**, but, as previously noted, these typically are paid by the *seller* in North Carolina and thus no amount should appear in Item #8 on page 2.] If the actual fees at settlement are *less* than those stated on the GFE, there is no violation. HUD-1 lines 801, 802 and 803 each have a separate zero tolerance threshold, not just the aggregate total on line 803 when compared with the adjusted origination charge.

10% Aggregate Tolerance Limit. This category includes all services required by the lender where the lender selects the provider (Item #3), *as well as* any services for which the borrower may shop, but chooses one of the providers suggested by the lender. These services may include lender's and owner's title insurance, title services, government recording fees, and any other service where borrower uses a provider on the lender's list, e.g., closing attorney, pest inspector, etc. *The total of these expenses at settlement (on the HUD-1) may not exceed the total of the estimated costs on the GFE by more than ten percent (10%).* In other words, they may not increase by more than 10%. If they do, then the lender has a tolerance violation. If the fees at settlement are less than the aggregate stated on the GFE, there is no tolerance violation.

Charges that Can Change by Any Amount. No tolerance limit applies to expenses in this category; in other words, these expenses may increase from the estimated costs on the GFE *by any amount* with no penalty to the lender. Expenses falling in this category include any services for which the borrower independently chooses the provider and the provider is *not* on the lender's list, as well as expenses for such things as homeowner's insurance, the initial escrow deposits (which are influenced by the amount of the homeowner's insurance annual premium) and daily interest charges. If the borrower selects their own closing attorney, then the attorney fees would fall in this category, rather than in the 10% tolerance category.

HUD-1 SETTLEMENT STATEMENT FORM

*Settlement agents must use a standardized closing statement form called the **HUD-1 Settlement Statement Form** in all transactions involving loans subject to RESPA, which is the vast majority of all residential sales transactions. It is also permissible to use this form in transactions where it is not required. The purpose of requiring use of this standard form is to assure that both buyer-borrowers and sellers are fully informed and aware of all settlement-related expenses. The HUD-1 form (or HUD-1A form in refinancing transactions) must show all the actual charges to the borrower and seller in connection with the transaction. Most of these charges will be itemized, but not all, as will be seen in the Section 1100 expenses to the buyer.*

Revised HUD-1 Form; Correlation to GFE Form

The new HUD-1 form is very similar to the HUD-1 that has been used for years and with which licensees are familiar. [See **Sample HUD-1 Form in these materials.**] The primary change is the addition of a third page to compare the actual settlement charges to the borrower

with the costs stated on the GFE form. The first two pages of the revised HUD-1 form are essentially the same as the old form in format and content, although there are some significant differences in how some entries are handled, especially on page 2 of the HUD-1. Note that many of the line items on page 2 of the HUD-1 form reference the corresponding line item on the GFE form.

The added third page of the revised HUD-1 form provides a chart for use by the settlement agent to compare the charges quoted in the GFE with the actual charges at settlement to assure compliance with the various tolerance restrictions. The charges stated on the GFE will be provided to the settlement agent by the lender for inclusion in the section on page 3 of the HUD-1 entitled “Comparison of Good Faith Estimate (GFE) and HUD-1 Charges.” The settlement agent may or may not receive an actual copy of the GFE. The third page also has a section for recording the basic loan terms, which also will be provided by the lender.

Handling Tolerance Violations

The RESPA rules grant the lender/originator a thirty day period to “cure” any tolerance violations. Thus, if a tolerance violation occurs, *it will not necessarily delay the settlement meeting*. The settlement agent can proceed with consummating the settlement and may actually record the deed and deed of trust and disburse the loan proceeds, as the lender has thirty days to remedy the violation by paying the borrower an amount equal to the violation. ***As a practical matter, the settlement agent most likely will contact the lender during (if not prior to) the settlement conference to receive instructions as to how the lender wants the settlement agent/closing attorney to handle the situation.***

It is anticipated that in most cases the lender will instruct the attorney to make whatever adjustment is necessary to cure the violation at the settlement conference. The cure will be reflected as a credit to the borrower in the 200 Section on page 1 of the HUD-1. Failure to cure will impair the ability to sell the loan on the secondary market as the HUD-1 will reflect on its face the uncured tolerance violation. Further, if the violation is not remedied at the settlement conference, then an amended HUD-1 must be issued whenever payment is made to the borrower by the lender, who most likely will pay whatever amount is due through the closing attorney. If the lender fails to cure the violation within thirty days of settlement, then the lender has violated Section 5 of RESPA.

Instructions for Completing the HUD-1 Form

These materials do not provide detailed instructions for completing the revised HUD-1 form because this document is completed by the closing attorney. Pages 1 and 2 of the revised form are very similar to the previous form and most entries are handled the same as with the previous form. *The reader is referred to HUD’s website at www.hud.gov/respa for general instructions and specific line-by-line instructions for completing the HUD-1 form.* There are, however, a few entries on the revised form that are handled differently than on the old form or that otherwise warrant a special mention. Thus, the following selected issues regarding form completion are briefly discussed.

Selected Issues Regarding HUD-1 Form Completion

[See Sample HUD-1 Form in These Materials]

General; Seller-paid Closing Costs. The basic rule is that if an expense is charged to the borrower on the GFE, then *it should appear in the borrower-buyer's column on page 2 of the HUD-1* in order to correlate with the GFE. *Even if a buyer's closing expense is actually being paid by the seller (e.g., seller paying all or a part of the buyer's discount points or other closing costs), the closing expense(s) being paid by the seller should still appear in the buyer's column on page 2 of the HUD-1 with adjustments made on page 1 in the form of a credit to the buyer in the 200 section and a corresponding debit to the seller in the 500 section.* Generally, a seller should not be charged for a buyer's closing cost on page 2 of the HUD-1. This is different from the common previous practice of showing on page 2 a charge to the seller for seller-paid buyer closing costs and no charge to the buyer for those costs.

Page 2 – Entries “Inside Borrower’s or Seller’s Column” and “Outside the Column.”

As with the previous HUD-1, there is a column for charges to the borrower and a column for charges to the seller. HUD's instructions for the revised form provide that for some line items, only a single total or aggregate charge for some related specific charges should appear in the borrower's column and specific entries related to that total or aggregate charge should appear on the appropriate line “outside the column” to the left of the two borrower/seller columns on the extreme right.

Section 700. Total Real Estate Broker Fees. *The revised form no longer calls for the sale price and brokerage commission percentage to be shown on Line 700.* This change was made in recognition of the fact that there are an increasing number of flat fee broker compensation arrangements that are not based on a percentage of the sale price. The HUD instructions call for the total typical seller-paid brokerage fee/commission to be shown on Line 700 and for the fee/commission splits between cooperating brokers or firms that will be disbursed by the settlement agent to be shown “outside the column” on Lines 701 and 702, with the total brokerage commission paid at settlement entered in the seller's column on Line 703. If a broker is retaining earnest money as part of the broker's earned fee, then only the amount actually disbursed at closing should be entered on Line 703 and a note should be entered “outside the column” on Line 704 indicating the amount of earnest money being retained as a “P.O.C.” item. If the **buyer** is paying a brokerage fee, this should be entered on Line 704 in borrower's column. Note that in sample completed HUD-1 forms seen to date by Commission staff, the total brokerage fee is often not being shown at all on Line 700, and this is not expected to be of concern to HUD.

Section 800. Items Payable in Connection with Loan. The entries in this section are taken directly from the loan origination charges section (Block A on page 2) of the GFE. The entries for Lines 801 and 802 should be “outside the column,” with the **adjusted origination charge** appearing in the borrower's column on Line 803. The entries for other related costs (**appraisal fee, credit report fee, tax service, flood certification,**

etc.) on the remaining lines in Section 800 will appear in the borrower's column if being paid by the settlement agent at closing. If a charge is paid prior to closing by the borrower (as is typically the case for the appraisal and credit report fees), then the charge would be shown "outside the column" as "P.O.C. by Borrower." *No charges should be entered in the seller's column in this section.*

Section 900. Items Required by Lender to Be Paid in Advance. Self-explanatory. All entries will be in the borrower's column.

Section 1000. Reserves Deposited with Lender. There should be *only one entry in the borrower's column on Line 1001 in this section!* That will be the total initial escrow account deposit the borrower must make at settlement. This section will have entries "outside the column" for **Homeowner's Insurance** (Line 1002), **Property Taxes** (Line 1004), and, if applicable, **Mortgage Insurance** (Line 1003); however, *the amount that appears on Line 1001 in the borrower's column often will be less than the subtotal of the itemized entries.* This is because RESPA rules require lenders to make a complex calculation to determine if there should be an "**aggregate adjustment**" amount entered "outside the column" on Line 1007 that should be deducted from the total of Lines 1002, 1003 and 1004 to determine the amount to enter in the borrower's column on Line 1001. The complex computation of the "aggregate adjustment" is beyond the scope of this instruction. *While real estate brokers are expected to be able to verify the calculations for escrow deposits for homeowner's insurance and property taxes (Lines 1002 and 1004), real estate brokers are not expected to know how to calculate the aggregate adjustment, only that it may result in the Line 1001 total being less than (but never more than) the total of Lines 1002, 1003 and 1004.* The aggregate adjustment is always either zero or a negative sum.

Section 1100. Title Charges. The revised RESPA rules prohibit the itemization of most title charges on either the GFE or the HUD-1. *The cost of all title services to the borrower and the premium for the lender's title insurance must be shown in one non-itemized lump sum amount on Line 1101 in the borrower's column.* "Title charges" include the following:

- Title Search/Examination Fee
- Fee for Document Preparation (for Lender and Borrower)
- Lender's Title Insurance Premium
- Notary Fees
- Courier/Delivery Fees (for Attorney to Send Closing Package to Lender)
- Attorney's Fee for Handling the Closing (if selected by lender or on lender's approved list.)

The amount entered on Line 1101 in the borrower's column will include the "outside the column" amounts for the **closing attorney's fee** (Line 1102) and for the **lender's title insurance premium** (Line 1104), but *will also include the costs for other title services listed above that are not itemized on the HUD-1.* Thus, the Line 1101 amount can not be obtained by taking the sum of outside the column entries in Section 1100. The cost of **owner's title insurance** is entered separately in the borrower's column on Line 1103. Lines 1104 through 1108 is title insurance information for the lender's benefit and may

be ignored by real estate brokers reviewing the HUD-1. Since the common practice in North Carolina is for the closing attorney to also prepare the deed for the **seller**, the cost for **deed preparation** is recorded on Line 1109 or a subsequent 1100 line *in the seller's column*.

Section 1200. Government Recording and Transfer Charges. *There will be only one entry in the borrower's column in Section 1200, and that is for **government recording charges** in the borrower's column on Line 1201.* In North Carolina, this figure will be the total of the recording charges noted "outside the column" on Line 1202 for recording the deed and mortgage. There is no charge for recording a release of the seller's mortgage in North Carolina as the release fee long ago was incorporated into the fee charged to record the Deed of Trust initially.

The question of how to handle the **North Carolina state excise tax**, which is a statutorily-imposed "transfer tax" that is paid by the **seller**, and any **county transfer tax** imposed by a county (allowed in a few NC counties) is a more difficult one. HUD's instructions state that any Line 1203 entry for "Transfer taxes" is to be made "in the columns" [note the plural]. Thus, it would seem logical that the seller's column for Line 1203 is an appropriate place to enter the amount of any transfer taxes (state or county) that are to be paid by the seller. However, HUD's "fillable pdf" HUD-1 form only allows an entry in the buyer's column for Line 1203, not the seller's column.

Line 1204 is for "City/County tax/stamps" and Line 1205 is for "State tax/stamps." HUD's instructions state that any entries here are "outside the column" (implying they are part of the borrower's charges shown in Line 1203), **but** HUD's "fillable" HUD-1 form for these lines only allows an entry in the seller's column and not the buyer's column. Thus, *it would seem that the most logical place to enter the **North Carolina state excise tax** is on Line 1205 both outside the columns beside "Deed" and inside the seller's column. Similarly, it seems most appropriate to enter any **county transfer tax** on Line 1204 both outside the column beside "Deed" and inside the seller's column.* This is the approach utilized in the sample HUD-1 form in these materials. Brokers should note, however, that they also may encounter the state excise tax (or a county transfer tax where applicable) entered on the blank Line 1206 in the seller's column (or a subsequent 1200 section line), and this may well be acceptable to HUD.

Section 1300. Additional Settlement Charges. This section must be used to record *charges to the borrower for lender-required services from providers that the borrower can choose, such as a **survey** or **pest inspection**.* The section may also be used to record *miscellaneous additional specific settlement charges to either the borrower or seller, such as charges for a **home inspection**, **environmental inspection**, **home warranty**, and **courier fee for delivery of payoff(s) of seller's mortgage or equity loan to the lienholder(s)**.* HUD instructions do not specify that borrower's charges must be listed outside the column in Lines 1302 and following with a single entry on Line 1301 in the borrower's column. Rather, the instructions say the amounts should be listed in either the borrower's or seller's column (as appropriate), so it may be acceptable to list all charges in this section separately in the appropriate column. Note that Section 1300 may also be used to show charges for **real property taxes** *in certain situations* as noted in the following comments on handling real property taxes.

Real Property Taxes for the Current Year that Are EITHER Paid Prior to Closing by Seller OR to Be Paid After Closing by Buyer. Note that these tax proration entries are handled in exactly the same manner as with the previous form.

Delinquent Real Property Taxes for the Previous Year. Although this is not addressed in HUD's instructions, the most logical approach seems to be to *include this as a charge to the seller in Section 1300*, and this is the approach believed to be most commonly used by closing attorneys.

Real Property Taxes for the Current Year to Be Paid at Closing by Settlement Agent. This situation occurs frequently with closings that occur after a tax bill has been issued (typically in July). However, the situation is not addressed in HUD's instructions and the Commission has found that attorneys use different methods to accomplish this proration of real property taxes. *The simplest approach and the one believed to be most widely used by attorneys is to charge the seller and buyer-borrower for their respective shares of the tax bill in Section 1300 on page 2 of the HUD-1 – the “double-debit” approach.* Brokers may also expect to encounter HUD-1s where the attorney charges the buyer-borrower for the full amount of the taxes in Section 1300, then credits the buyer-borrower for the seller's share of the taxes in Section 200 and charges the seller for the same amount in Section 500.

Second Loan Used to Finance Part of Purchase Price. Although a less likely occurrence today than a few years ago, occasionally a first mortgage lender will allow a second mortgage, possibly in the form of a home equity line of credit (HELOC) to be used to finance a portion of the purchase price. In this situation, the second mortgage loan amount should be entered on Line 204 or ff. blank line as an “amount paid by or in behalf of the borrower” on the HUD-1 for the first mortgage loan AND *a separate GFE and HUD-1 are required for the second loan.*

Broker's Responsibilities Relating to Closing Statements

Because the accuracy of the closing statement is of paramount importance to the parties in a transaction, and because a real estate broker is expected to possess the competence necessary to protect the interests of those parties, *a real estate broker is expected to have a thorough understanding of closing statements.*

Verifying Proper Completion of HUD-1 Form

In virtually all residential transactions in North Carolina, the closing statement is prepared by the closing attorney prior to the settlement meeting using the **HUD-1 Settlement Statement Form**. *Each broker involved in a transaction, regardless of his or her agency relationship with the respective parties, is expected to review the completed HUD-1 statement and to verify its accuracy and completion in accordance with the provisions of the sales contract. The broker is expected to confirm the accuracy of those entries about which he or she*

has direct knowledge. These would include items from the sales contract like the sale price, earnest money and due diligence fee, if any, as well as items such as the brokerage commission.

With regard to entries on the HUD-1 representing amounts due to or from third parties, the broker may generally assume that the **amounts** for the charges and credits cited in the settlement statement are correct unless there is some reason that would lead a reasonably prudent broker to believe they are incorrect. ***However, the broker is expected to assure that:***

- (1) all relevant charges and credits are charged or credited to the appropriate party, namely, either the borrower-buyer or the seller,
and
- (2) all calculations for prorated items, escrow reserves, interim interest, excise tax and “bottom line” figures (i.e., total settlement charges for borrower-buyer and seller, cash from borrower-buyer and cash to seller) are correct.

The closing attorney should be immediately advised of any suspected errors or omissions detected. In rare instances, a broker *may* attempt to personally conduct a settlement, although this is highly discouraged. In that event, the broker *should* have an attorney prepare the HUD-1 statement, but *if the broker were to attempt to personally prepare the statement, he or she would be held strictly responsible, without exception, for accurate preparation of the HUD-1 statement.* Whoever is acting as the settlement agent is the individual who ultimately is responsible for the accuracy of the HUD-1.

Providing Copies of Closing Statement to Parties

North Carolina Real Estate Commission Rule 58A.0107(c) requires real estate brokers to furnish both the seller and buyer a closing statement either at the closing or not more than five days after the closing. This requirement is satisfied if the broker assures that the closing attorney provides a copy of the completed HUD-1 form to the parties. Note that some attorneys only provide the seller with a HUD-1 showing the seller’s charges, credits and bottom line and the buyer with a HUD-1 showing the buyer’s charges, credits and bottom line. When this is done, the requirement is also considered to be met.

In non-residential transactions, the closing or settlement statement will not be on a HUD-1 form, and most likely will be prepared by an attorney, although it is possible that a broker could personally prepare the closing statement. The standard expected of brokers is the same as that described above for a HUD-1 form.

Real Estate Broker Acting as Settlement Agent

Real estate brokers should note that the North Carolina State Bar’s ethics opinion allowing settlement meetings to be conducted by nonlawyer assistants *acting under an attorney’s supervision* should *not* be interpreted to mean that real estate brokers can now conduct real estate closings. While a broker may infrequently be called upon to coordinate certain aspects of closing a transaction they have brokered, **brokers are strongly discouraged from attempting to conduct settlement meetings and any broker doing so will be held strictly responsible by the North Carolina Real Estate Commission for assuring that all aspects of the settlement/closing s/he is conducting are handled properly.** The broker must utilize the

services of an attorney to perform all closing functions that are required to be performed by an attorney. Such functions include, but are not limited to, preparing deeds and other documents, explaining the parties' rights and obligations, and offering any opinion about the nature or quality of the title to be transferred. A real estate broker should be extremely careful not to engage in the unauthorized practice of law.

*If a broker does personally conduct a real estate settlement/closing (utilizing an attorney to perform those functions that must be performed by an attorney), the broker **must** deposit all funds paid by or on behalf of the buyer into his or her brokerage trust account and then make all required disbursements directly from the trust account.* It is not proper for a broker/firm to use a business or personal account for this purpose, as this would constitute illegal "commingling" of the parties' funds with the broker's funds. It is permissible for a broker/firm conducting a closing to disburse the entire brokerage fee earned to his/its business account and then disburse portions of that fee to the broker's/firm's agents or to a cooperating broker/firm, as appropriate; *however*, it is recommended that all earned brokerage commission payments to the broker/firm and to a cooperating broker/firm *be made directly from the broker's trust account and reflected on the settlement statement in order to create a complete record of all disbursements on the settlement statement.* At a minimum, the brokerage commission split between the broker handling the closing and any cooperating broker or firm should be shown on the settlement statement.

SAMPLE GOOD FAITH ESTIMATE AND HUD-1

A sample Good Faith Estimate and corresponding HUD-1 Settlement Statement appear on the following pages. The sample GFE and HUD-1 illustrate a settlement where there was a tolerance violation and how it was cured. The facts underlying the HUD-1 are as follow:

- Purchase price of the house and lot is \$175,000.00.
- Closing date is August 30, 2010
- Earnest money deposit = \$1,500.00; due diligence fee = \$350.00.
- Financing: 30 year FHA loan in an amount equal to 96.5% of the purchase price; 1% origination fee and buyer paying 1 discount point for a fixed interest rate of 5%.
- The buyer is required to purchase private mortgage insurance with an *initial up-front payment* equal to 2.25% of the loan amount that is *added to the base loan amount*.
- Lender charges a \$525.00 commitment/underwriting fee, an \$85.00 administrative fee, and a \$15.00 wire transfer fee, in addition to the loan origination fee.
- Seller agrees to pay \$3,000 towards buyer's closing costs.
- City and county taxes are \$2,000/year; lender requires an escrow deposit equal to 11 months.
- Homeowner's insurance premium is \$720.00 per year with the first year's premium to be paid at closing and an escrow deposit equal to three months.
- Buyer selects a closing attorney recommended by the lender. While the lender estimated the attorney's fee to be \$425, the attorney charges the buyer \$640 for the closing and charges the seller \$125 for the deed preparation.
- Brokerage commission to listing company = 5% of the sales price that the listing company shares equally with the selling company.

- Title insurance premium is \$2.00 per thousand up to \$100,000, and \$1.50 per thousand between \$100,001 and \$500,000. Lender's policy is for the total loan amount and owner's policy is for the purchase price.
- Express courier fees are \$30.00 to overnight the executed loan package and recorded Deed and Deed of Trust to buyer's lender and a total of \$60 to overnight the payoff amounts to seller's two lienholders (first mortgage and home equity line).
- Fees to record Deed = \$25.00 and Deed of Trust = \$63.00. Excise tax based on standard rate.
- Buyer uses a pest inspector that is on the lender's list of recommended providers.

Comments:

96.5% of the \$175,000 purchase price is \$168,875.00. 2.25% of \$168,875 is \$3,799.69 for the up-front mortgage insurance payment, which is added to the principal amount of the loan, resulting in a total loan amount rounded to \$172,675.00 as stated on page 1 of the GFE. Lender's title insurance is based on the \$172,675 and the charge to buyer for the owner's policy is based on the \$2,325 difference between the purchase price and the total loan amount.

The origination charge in Block 1, page 2 of the GFE includes the 1% loan origination fee of \$1688.75, plus the \$525.00 commitment/underwriting fee, the \$85.00 administrative fee and the \$15.00 wire transfer fee. The discount point is reflected in Block 2. GFE Item 4 charges include an estimated \$103.31 for the lender's title insurance premium and \$425.00 for attorney fees.

On **page 2 of the HUD-1**, note that the total in buyer's column in the 1000 Section is the total of all the sums outside the column, i.e., $(\$180.00 + \$1833.37) - 420.04$ [aggregate adjustment] = \$1593.33. The same is *not* true of the Section 1100 total. ***Section 1100 is the only section where the number in the column may include charges not itemized in the section.*** The total premium to the title insurer on line 1107 (\$312.50) is the \$309.01 for the lender's policy + the \$3.49 for the owner's policy. However, if one adds lines 1102 (\$640.00 attorney fee - lender's provider) and 1104 (\$309.01 lender's title insurance premium) the total is \$949.01, so why is the 1101 total \$979.01? Because it includes the \$30 express courier fee to overnight the closing package back to the lender required as part of the title services but *not* itemized below. Some closing attorneys may have a supplemental worksheet to show the buyer all charges included in the 1101 total; others may not, but the buyer could always ask what exactly is included in that total.

In reviewing page 3 of the HUD-1 comparing the actual closing costs to the GFE estimates, there is no difference in the zero tolerance category. In the 10% tolerance category, the estimated expenses were \$4751.66 and the actual expenses to the buyer were \$5402.36 — a difference of \$650.70, or 13.7%. Here, there is a tolerance violation. Does the lender then owe the buyer \$650.70? No; the lender has a permissible variance of 10%. Ten percent of \$4751.66 is \$475.17 which when subtracted from the \$650.70 overage yields a difference of \$175.53 which is the amount the lender owes the buyer. It is reflected on line 208 on page 1 of the HUD-1.

If the amounts on the HUD-1 in either category one (zero tolerance) or two (10% aggregate tolerance) had been *less* than the estimated costs stated on the GFE would there be a tolerance violation? No. So long as the actual closing expenses are less than estimated, there is no problem; the problem only arises where the actual expenses exceed the estimated expenses by any amount in the zero tolerance and by more than 10% in the second category.

RULE: However, in calculating these expenses, HUD's position is that: "*Charges for settlement services that are disclosed on the GFE or would have been appropriate to disclose on the GFE, **whether the charges are paid by the borrower, paid on behalf of the borrower or paid outside of closing, must be listed in one of the three tolerance categories of the Comparison Chart on page 3 of the HUD-1.***"

Thus, HUD's position is that *if it was on the GFE*, and thus obviously viewed as a buyer expense, *then it needs to stay in Borrower's column on page 2, with an offsetting credit on page 1 for closing costs paid by seller or other borrower expenses paid by third parties*. Even if a settlement agent places such a borrower expense in seller's column on page 2, the expense nonetheless should be treated as paid by buyer and included in the appropriate tolerance category in the comparison chart on page 3.

No total is required in the last category, because those expenses may change and are not subject to any tolerance limits.

HOME WARRANTY POLICY REBATES TO BROKERS

While not directly related to the subject matter of this Section, licensees should know that, after many years, the RESPA section of HUD finally issued an interpretive ruling in late June 2010 as to whether payments by home warranty companies to real estate brokers for "selling" the policy were in essence nothing more than referral fees, and thus illegal, under Section 8 of RESPA, or whether they constituted "earned fees" for services provided by the broker, which would be legal. *In its ruling, RESPA has held that, in general, payments from home warranty companies (HWC) to brokers when the seller or buyer in a transaction in which the broker is acting as an agent purchases a home warranty policy are illegal kickbacks under RESPA.* (Generally, the only "settlement service providers" who may pay referral fees to each other under RESPA are real estate brokers to other real estate brokers.)

HUD/RESPA will look at the facts of each case to determine whether a payment was a referral fee or whether it was reasonable compensation for services provided. Licensees can find a copy of HUD's interpretive rule by going to www.hud.gov/respa and clicking on the link on the home page for home warranty rebates/ruling. Factors HUD will consider include whether the broker's arrangement with the HWC prohibits the broker from recommending other home warranty companies, and whether compensation is tied to the number of transactions referred. Oral "sales pitches" concerning a particular home warranty company and its products, or distributing promotional materials of a home warranty company at a broker's office or open house are viewed as "marketing" by HUD/RESPA and any payment to the broker therefor would be illegal.

However, compensation for “earned fees” has always been permitted under RESPA. In its ruling (FR-5425-IA-01, Vol 75, #122, Federal Register, June 25, 2010), HUD holds:

Services performed by real estate brokers and agents on behalf of HWCs would be *compensable* as additional settlement services *only if* the services are *actual, necessary and distinct* from the primary services provided by the real estate broker or agent. Further, the real estate broker or agent may accept, and an HWC may pay to the broker or agent, a portion of the charge for the homeowner warranty only for services that are *not nominal and for which there is not a duplicative charge*.

[Italics added.]

HUD looks at the actual services provided to determine in a particular case whether compensable services have been performed by the real estate broker or agent. According to a footnote, examples of “compensable services” may include: 1) actual inspection of items to be covered by the warranty to identify pre-existing conditions that might affect warranty coverage; 2) recording serial numbers of the items to be covered; 3) documenting the condition of the covered items by taking pictures; and 4) reporting inspection results to the HWC.

HUD will also assess “...whether the value of the payment by the HWC is reasonably related to the value of the services actually performed by the real estate broker.” Factors that may influence the determination as to “compensable services” versus “referral fee” may also include whether:

- there is a contract between the broker and HWC as to the scope of services to be provided;
- the services are actually performed and don’t duplicate services normally provided by real estate brokers in sales transactions;
- the broker is acknowledged to be the *legal agent of the HWC*, preferably *by contract*, and the HWC is bound by the broker’s representations as to the warranty product; **and**
- the broker has “fully disclosed to the consumer the compensable services that will be provided and the compensation arrangement with the HWC, and has made clear that the consumer may purchase a home warranty from other vendors or may choose not to purchase any home warranty.”

For the past several years, the Commission has held that until HUD/RESPA decided whether fees paid to brokers by home warranty companies for selling a warranty product constituted glorified referral fees or true “earned fees,” brokers could receive such fees *so long as the broker properly disclosed to the principal or party the amount s/he or the company was receiving in compliance with Commission Rule A.0109*. However, now that HUD has issued this interpretive rule, it would appear that the vast majority of payments from home warranty companies to brokers are deemed referral fees **and will henceforth be prohibited**, unless a broker or company satisfies the test for “earned fees” or compensable services” enunciated in HUD’s ruling.