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GRAPPLING WITH 'GOOD FAITH'

New disclosure law prompting lenders to inflate costs -- and buyers to panic

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By Candace Taylor

CLOSING COSTS

Last month, mortgage banker Bruce Maasbach got a panicked call from a friend's daughter, who was about to close on a New York City co-op.

The buyer told Maasbach she was reluctantly considering purchasing an apartment in an all-cash deal because she'd just received an estimate from her bank putting the cost of closing her loan at $12,000. That's more than triple the usual closing costs for a co-op, said Maasbach, the managing director of the Manhattan division of mortgage bank Luxury Mortgage.

"She was rather taken aback," said Maasbach. "She said to me, 'I'm not spending this kind of money [on fees].'"

Maasbach has received many similar calls since January, when new federal regulations went into effect governing the "good faith estimates" that lenders issue to mortgage applicants, outlining loan fees and other closing costs.

The new regulations require estimates of all mortgage origination fees and transfer taxes to be identical -- sometimes down to the cent -- to the fees charged at the closing table. If the fees exceed the estimates, the lender, not the borrower, must pay the difference.

The changes are meant to make the mortgage process more transparent for consumers, and to eliminate the unexpected fees that commonly popped up at the closing table during the boom.

But experts say the revisions are having unintended consequences. Because New York City's closing costs are so high -- they can be 5 to 6 percent of the loan amount -- one mistake could easily cost the loan originator tens of thousands of dollars.

"It's huge money," said Richard Martin, a senior vice president at DE Capital Mortgage -- a partnership between Wells Fargo and brokerage Prudential Douglas Elliman. In New York, he said, "the stakes are vastly higher" than in other places.

Because lenders and mortgage brokers fear being on the hook for mistakes, they are greatly overestimating closing costs, causing confusion and often panic among buyers, experts noted.

The complicated new GFE process is slowing down deals just as the market is starting to pick up. And while the new regulations are intended to save consumers money, they are actually costing them more, at least in the short term.

"Deals are more expensive to do, because people are so nervous about the numbers being correct on the good faith estimate," said Maasbach, explaining that some New York-area banks and mortgage brokers are increasing application and processing fees by roughly $100 per transaction, in part to account for the labor required to check and recheck GFEs.

In the past, good faith estimates had "no teeth," said Brian Sullivan, a spokesperson for the U.S. Department of Housing and Urban Development.

"You'd begin the process of getting a loan, and then 60 days later you're going to closing, and you're presented with a loan that doesn't resemble what you were offered," he said.

The new GFE is a standardized form that must be generated within three days of the initiation of a mortgage application. In addition to the fact that estimates for lenders' fees and transfer taxes must be practically identical to the final fees paid, a variation of only 10 percent is allowed for estimates of nonlenders' costs, like title insurance and appraisal fees. If the estimates aren't close enough, the lender pays the difference (there is no penalty for the buyer). If there is a material change, such as a change in the price of the unit, a new GFE must be generated.

Many mortgage brokers and lenders agreed that borrowers should be offered more transparency, but say there are problems with the implementation of the new rules.

First, in a climate where getting a mortgage is far from assured, many buyers start the process of applying for a loan after their offer has been accepted, but before the contract has been signed. That often means the terms of the agreement are still being ironed out while the lenders are generating the GFE, which can lead to delays or costly mistakes, as one lender discovered at the closing of a $1.7 million Upper East Side co-op in April, Maasbach said. The lender forgot to disclose the mansion tax (paid by buyers of homes over $1 million). As a result, the lender had to fork over $17,000 at the closing table, he said.

To avoid mistakes likes these, "you can imagine that there's a lot of double-measuring and double-checking before the deals get to closing," said Jeffrey Appel, a mortgage loan officer at Bank of America. "If an error is picked up, there's a delay."

The costs get passed on to consumers, in the form of higher bank fees and late fees if their closings are delayed.

The new rules also require mortgage brokers and lenders to spend time on the phone with vendors, like title insurance providers, finding out how much they charge, explained real estate agent and mortgage broker Richard Bouchner, founder of Bouchner & Co. Real Estate.

To protect themselves from possible mistakes, many loan originators inflate their estimates. "If someone tells me $1,200, I'm going to put down $1,500," said Bouchner. "I'd rather be way higher."

Many also list fees -- like transfer taxes -- that they know will likely be paid by the seller, just in case. That often causes confused buyers to panic, which can jeopardize a deal, especially if the contract hasn't yet been signed. "The client will get this enormous number and be calling us, hysterical, saying, 'How could my closing costs be so high?'" Maasbach said.

HUD is aware that the new law presents some "challenges from an operational point of view," Sullivan said. But policymakers believe the problems will fade away as lenders become more comfortable with the new regulations.

"We do believe that as time goes on, and they become more fluent in these new rules, they won't feel the need to inflate their costs," he said.