

Testimony of

Debra Still

On Behalf of the

National Association of Home Builders

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on the

U.S. Department of Housing and Urban Development's

RESPA Proposal

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Introduction

Chairman Watt, Ranking Member Miller, distinguished Members of the Subcommittee on Oversight and Investigations, on behalf of the more than 235,000 members of the National Association of Home Builders (NAHB), thank you for this opportunity to testify today on the important subject of the U.S. Department of Housing and Urban Development's (HUD's) Proposed Rule to change its regulations relating to the Real Estate Settlement Procedures Act of 1974 (RESPA).

My name is Debra Still. I am president and chief executive officer of Pulte Mortgage LLC in Englewood, Colorado, which is a subsidiary of Pulte Home Corporation, a publicly traded company. I want to thank you for holding this hearing to bring focus to HUD's RESPA proposal and to explore ways this proposal can be changed to improve mortgage loan disclosures for consumers while preserving many of the benefits consumers enjoy today by being able to choose the mortgage and title alternative that best serves their needs.

In my testimony, I will broadly outline the major components of HUD's proposal. My primary focus, however, will be on HUD's proposed definition of "required use," which, if enacted as originally proposed, would have an immediate negative impact upon many consumers who purchase new homes. As proposed, this definition would prohibit a home builder from offering any incentive in exchange for a home buyer's use of the builder's affiliated mortgage or title companies or any other builder-affiliated business. In my testimony, I will describe the reasons why home builders offer these incentives to consumers and how the incentives improve the home buying experience. I will also propose an alternative definition which, if implemented, would continue to allow builder incentives while properly addressing HUD's concerns.

Summary of HUD's Proposal

HUD issued its proposal to revise RESPA regulations on March 14. This proposal is the latest attempt at RESPA reform by HUD. Prior to issuing this proposal, HUD had unsuccessfully proposed widespread RESPA reforms in 2002, which were withdrawn in 2004.

HUD states that its objectives in issuing the proposed revisions to RESPA are "to simplify and improve the process of obtaining home mortgages and to reduce settlement costs to consumers." A guiding principle in HUD's proposal is that increased competition among lenders, as a result of borrowers' improved ability to shop for mortgage credit, will put pressure on lenders and other settlement service providers to pass cost savings on to borrowers. To this end, HUD has proposed several changes to the Good Faith Estimate (GFE) and the HUD-1 settlement statement, including:

- A standardized four-page Good Faith Estimate (GFE) form, which is provided to a borrower prior to closing their loan, that provides a summary of loan terms and settlement charges to enable the borrower to comparison shop for a mortgage loan;

- More accurate estimates of final settlement charges through the imposition of tolerances to limit increases in GFE estimates at closing;
- Revised requirements for disclosure of mortgage brokers' commissions, or "yield spread premiums" (YSP), in detail on the GFE, including the effect various rates would have on the YSP;
- Allowing lenders and brokers to seek discounts, including volume-based discounts, for settlement services as well as the use of average cost pricing for settlement services instead of actual cost;
- Revisions to the HUD-1 loan settlement statement to facilitate comparison with the information provided on the GFE; and,
- An addendum to the revised HUD-1 that would require loan closing staff to prepare and read a specific "closing script" to borrowers that explains final loan terms and settlement costs and any differences that exist between the final terms/costs and the GFE.

In addition, HUD proposes to change the definition of "required use" to include tying an incentive to, or conditioning the ability to avoid a disincentive on, the use of a particular settlement service provider. Settlement services, or optional combination of services, from a specific settlement service provider that are less than the cost of individual settlement services would be exempted from the definition of required use.

Overview of NAHB's Position

NAHB supports HUD's stated goal of improving the mortgage process and reducing the cost of these transactions for consumers. NAHB also endorses the concept that consumers should be provided with sufficient information to enable them to understand the terms of a mortgage loan for which they are applying and that the process of shopping, or comparing loan alternatives, should be as simple and straightforward as possible.

NAHB believes that free and open competition among service providers results in the greatest benefit for consumers who are purchasing new homes. These benefits extend beyond purely financial considerations and include issues relating to certainty that home sales will close in a timely manner and that the terms, costs and characteristics of the related financing arrangements conform to the settlement services that the consumer sought.

While NAHB agrees with HUD's intent to simplify and improve the process of obtaining mortgages and to reduce hidden consumer settlement costs, we believe portions of the proposal will not meet this objective and would in fact negatively impact consumers. Of paramount concern to NAHB is the proposed change to the "required use" definition. This proposal would eliminate home builders' opportunity to offer *bona fide* incentives to consumers when the availability of those incentives is linked to consumer use of home builders' affiliated mortgage and title companies, resulting in significant increases in costs to home buyers.

The bulk of our statement will address our concerns with the proposed required use definition and the adverse impact it would have on numerous NAHB members who have affiliated mortgage and title companies, and more importantly, on consumers. As discussed further below, NAHB urges HUD to broaden the proposed definition to recognize the value that builder affiliates can bring to consumers through the loan, title and closing processes. Our statement also addresses concerns with the applicability of HUD's proposed changes to the Good Faith Estimate to the settlement process for the purchase of a newly built home.

“Required Use” Definition

RESPA regulations prohibit participants in the sale, financing and settlement of a home from requiring the buyer to use the services of an affiliated settlement service company. There is an exception for situations where the buyer is offered a service at a discounted price, or offered another incentive for using an affiliated company, as long as the use of the affiliate is optional and the discount or incentive is genuine and not made up by higher costs elsewhere in the transaction. HUD has expressed concern that the current regulatory definition of required use does not protect home buyers from confusing or disingenuous referral arrangements and, as a result, buyers are not able to determine their best option.

HUD specifically cites arrangements where a home builder offers price reductions or additional amenities on a home in exchange for the buyer's use of the builder's affiliated mortgage or title company. HUD says that consumers have complained that rates and fees charged by affiliated mortgage companies are higher than those available from unaffiliated companies; that builder incentives are imbedded in the price of the home and, therefore, are not true incentives; and, that incentives are so large that the option of not using the affiliated company results in an overwhelming penalty that compels the buyer to use the affiliate. HUD's proposed solution is to revise the required use definition in a way that excludes all persons and organizations other than settlement service providers from offering an incentive for use of an affiliated company. As a result, home builders would not be allowed to offer such incentives.

NAHB strongly disagrees with this portion of HUD's proposed revisions to the RESPA regulations. While NAHB agrees that excessive or deceptive incentives for affiliate use should not be permitted, HUD's proposal would also eliminate *bona fide* incentives, denying consumers significant savings in their home purchases. NAHB maintains that the examples of required use problems given by HUD are ambiguous and incomplete. Moreover, they do not represent the vast majority of home builders providing incentives for buyer use of affiliates, who do so in a responsible manner that brings substantial benefits to consumers.

Builders Seek Favorable Relationships with Home Buyers

Home builders have a strong interest in establishing and maintaining positive relationships with their buyers. When developing communities, builders are not involved

in short-term, one-time transactions. Home builders commit millions of dollars in resources and significant human capital toward the planning and construction of the communities they develop. Most builders construct and sell homes in the same communities year after year and, therefore, place a premium on maintaining a reputation built through favorable customer reviews and exemplary corporate citizenship.

Builders look to purchasers of their homes for repeat business and referrals, which is not possible unless consumers are satisfied with their home purchases and related settlement service transactions. Consumers will only refer their friends and relatives to a builder when they believe they have been treated fairly and received excellent value for their investment. A good reputation in the home building business takes many years and transactions to establish, but this hard-earned reputation could be easily tarnished by a handful of bad experiences. The last thing home builders want is to have disgruntled purchasers.

In addition, an integral component of that effort is ensuring that consumers receive competitively priced mortgages that enable them to enjoy their homes without undue financial burden. Therefore, it is in a home builder's self interest to make every effort to avoid foreclosures, which harm consumers and the communities in which they live.

In order to ensure that high customer satisfaction levels are achieved and maintained through the home buying and mortgage financing processes, many home builders conduct post-purchase customer satisfaction surveys at closing and at regular intervals afterward. J.D. Power and Associates also conducts surveys in certain markets, as cited in HUD's Regulatory Impact Analysis, which states,

“A recent study by J.D. Power found that the majority of borrowers surveyed who finance through a builder's affiliate were satisfied with the experience. According to J.D. Power, borrowers claimed that they chose to borrow from builder affiliates because the interest rates were competitive and that the process was easier.”¹

The home building business is highly competitive, with over 80,000 firms engaged in the primary business of building and selling single family residences. If a home builder does not offer consumers new homes at fair prices, combined with settlement services at fair terms, these consumers will choose a more desirable alternative.

The process of buying a new home, with the myriad of choices and options, is very complex and often requires several months to consummate. Understandably, home builders want these complex transactions to flow as smoothly as possible and they strive to ensure that consumers' home buying experiences are as positive as possible.

Why do home builders establish affiliates?

As part of the effort to build strong consumer relationships, many home builders have established settlement service affiliates, such as mortgage and title companies. A

¹ RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, page 3-79.

number of NAHB's builder members have established wholly-owned mortgage and title affiliates or have formed joint ventures with mortgage lenders and title companies. Collectively, these relationships have successfully facilitated home purchases for hundreds of thousands, perhaps millions, of consumers over a span of more than a decade.

Home building companies that have affiliated mortgage and title companies have formed these affiliates primarily to improve the overall customer experience and to improve the likelihood that the home sale closing occurs as promised and in a timely manner. For home builders, these affiliates provide economic benefits to the consumer that far outweigh the income received from the builders' ownership in the businesses.

In the conditions that have prevailed during the past year, where mortgage financing has become unstable and uncertain, these relationships have taken on greater importance. Many home builders can document sales numbering in the hundreds that were originally scheduled to have been financed by outside lenders that failed to take place and were subsequently "saved" by the builder's affiliated mortgage company. Had the builder's affiliate not been prepared to step in at the eleventh hour, it is unlikely that these consumers would have been able to move forward with their purchase. If they did, their mortgage would have had much less favorable terms.

An explanation of the complexity of the home building business might help to put into perspective a few of the reasons builders establish mortgage and title affiliates. At any given time, some builders may have much of their backlog of homes under construction. The affiliate relationship fosters a high degree of accountability between the builders and affiliates, which leads to well-coordinated, efficient transactions that have a high likelihood of closing on time without any "surprises" for the consumer or builder.

In the home building business, there is typically a push by consumers, sellers and lenders to close the bulk of home purchases at the end of each month. Without the coordination, communication and focus afforded by home builders' affiliates, opportunities increase for slip-ups that delay closings. Every loan that fails to close on time represents a tremendous inconvenience for a new home buyer and also carries significant additional inventory, marketing and reputational costs for a home builder.

Studies of builder-affiliated mortgage companies conducted by the research firm Wholesale Access have found that builder-affiliated mortgage companies have lower per-loan operating costs as compared to outside lenders². The savings from these economies and the other affiliate benefits are difficult to quantify; however, they are significant and are routinely passed along to consumers in the form of incentives for use of a builder affiliate.

In practice, these affiliated relationships allow builders to manage their primary business of building and selling homes with far greater economic efficiency. HUD's

² Builder Benchmark – A Production Revenue and Expense Comparison, a series of private surveys conducted for selected builder-affiliated mortgage companies by Wholesale Access Mortgage Research and Consulting, 2001-2006.

proposal fails to account for the substantial savings that builders realize through affiliated businesses, and are able to pass on to consumers. Contrary to HUD's assertion, home builders in general do not increase the selling prices of homes to offset these incentives. The competitiveness of the marketplace simply doesn't allow this to occur.

Builder Affiliates Compete for Business

It is important to note that the sales personnel of home builders are free to refer consumers to any mortgage and title company and place top priority on ensuring that the home sale will close smoothly and on time. Therefore, builder-affiliated mortgage companies must compete for every referral. Service and price are the primary factors that determine if a home builder's sales representative refers a home buyer to a particular lender. Surveys conducted from 2001 through 2006 indicate that builder-affiliated mortgage companies can expect to finance sixty to eighty percent of the sales of their related builders³. That these capture rates have remained relatively steady over several years is a strong testament to the competitive nature of the settlement services marketplace as well as to consistent quality of service the affiliated mortgage and title companies provide to purchasers of the parent companies' homes.

Proposed HUD Definition

NAHB does not believe HUD has established a sound basis for the proposed changes in the definition of required use. HUD supports its proposal entirely with anecdotal, incomplete and unsubstantiated examples that have been advanced previously by outspoken opponents of affiliated businesses.⁴ The examples cited as problems appear to be violations under the current RESPA regulations and could be addressed accordingly.

Furthermore, HUD has not provided any empirical studies or other statistical information that substantiate its position that consumers are harmed by using builder affiliated service providers. NAHB suggests that, in developing this proposal regarding required use, HUD's research does not conform to the data quality requirements that are imposed upon all federal rulemakings by the statute commonly known as the Information Quality Act.⁵

HUD's final Information Quality Guidelines as published in the Federal Register on November 18, 2002, read as follows: "HUD will ensure that the information it disseminates to the public is objective (accurate, clear, complete and unbiased), useful, and has integrity." NAHB submits that the justification for the proposed changes to the required use definition does not meet these criteria.

³ Ibid.

⁴ RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, pages 3-77 and 3-78.

⁵ Section 515 of the Treasury and General Government Appropriations Act for Fiscal Year 2001, Public Law 106-554.

NAHB Recommendation

As previously stated, NAHB believes HUD has not provided adequate justification to change the required use definition. However, if HUD proceeds with changes to the definition, NAHB suggests the following:

“Required use means a situation in which a person’s access to some distinct service, property, discount, rebate or other economic incentive, or the person’s ability to avoid an economic disincentive or penalty, is contingent upon the person using or failing to use one or more referred providers of settlement services, and the person will pay more than fifty percent (50%) of the total charges of the applicable settlement service provider(s), either directly or by payment of a charge, all or part of which is used to pay for the settlement service(s). An offer of any benefit to the person by any individual or entity based on the person’s use of one or more particular settlement service providers does not constitute a required use of the provider(s) if the following conditions are satisfied:

1. The offered benefit consists of one or both of the following, or any combination thereof:
 - a. The payment, or provision of funds or a credit for the payment, of one or more financing, closing and/or settlement costs of any provider(s) in any amount, or a reduction of one or more of such costs by any amount.
 - b. The payment, or provision of funds or a credit for the payment, of the base price of a home, the price of any option(s) for the home and/or the price of any upgrade(s) for the home, or a reduction of the base price of the home, of the price of any option(s) and/or the price of any upgrade(s), in a total amount up to six percent (6%) of the pre-discounted base price of the home.
2. The person has a choice to accept or decline the benefit arrangement.
3. The total amount payable by the person for the financing, closing and settlement costs and the property being purchased, with any options and upgrades, in connection with the transaction would be higher without the offered benefit.

Additionally, the purchase by a builder or seller from a lender of a forward commitment pursuant to which the lender will make an aggregate amount of financing available to purchasers of homes from the builder or seller under the terms of the commitment does not constitute a required use of the lender. The terms of the commitment may include, without limitation, financing at a combination of interest rate and points that is lower than otherwise available from the applicable lender without the commitment. Without limiting the foregoing, there is no required use of a lender if a home purchaser obtains financing from a lender pursuant to such a forward commitment, and also accepts an offered benefit

satisfying the conditions set forth above that is based on the use of the same or a different lender.”

In explanation of the alternative proposal:

- The NAHB proposal uses the term “person” to refer to the party who is offered a benefit, rather than “borrower.” HUD’s proposal uses the term “borrower,” which appears to be too narrow to encompass all types of purchasers of settlement services.
- The NAHB proposal refers to the party that can offer a benefit as an individual or entity. This is because the definition of “person” under RESPA refers to individuals, corporations, associations, partnerships and trusts, but not limited liability companies.
- Following HUD’s approach, the NAHB proposal includes access to a discount, rebate or other economic incentive that is tied to use of a particular provider as a required use. The result is that benefits tied to the use of an affiliate or a particular title company would be limited to settlement/closing cost discounts and the like and/or home, option and upgrade discounts and the like. The home-related incentives would be limited to a specific percentage of the home sales price. This is consistent with HUD’s goal to better define what benefits qualify as exceptions to the general required use prohibition.
- The proposal includes the element from the existing definition that a person must pay for a service in order to have a required use, but establishes a floor that would require the person to pay more than 50% of the applicable charge(s). If a person paid 50% or less of the charges of the applicable provider, there would be no required use of the provider. Instead of using the current language that the person pays for the service directly or pays a charge “attributable, in whole or in part, to the settlement service,” the NAHB proposal would require that the person pay more than 50% of the total charges of the applicable settlement service provider directly or by payment of charge, “all or part of which is used to pay for the settlement service(s).”
- The definition seeks to better define the condition that the benefit arrangement be optional to the person by stating as a condition that the person has a choice to accept or decline the benefit arrangement. The intent is to avoid the concept of “optional” that could still present issues as to the interpretation of what is “optional.” As drafted, the alternate proposal avoids this complication by requiring simply that the person has a choice to accept or decline the benefit.
- A third condition addresses HUD’s concern as to whether a benefit provides a “true discount.” The approach is that the total costs to the person of the transaction (home and settlement/closing costs) with the benefit is lower than the total costs

without the benefit. Simply stated, if the deal with the benefit is at a lower cost, then the benefit must provide a “true discount.”

- The NAHB proposal includes the clarification that forward commitment arrangements for financing do not constitute a required use, even if combined with a benefit arrangement that involves the same or a different lender. Under the proposal, the “terms of the commitment” may, but do not have to, provide for a lower combination of rates and points than is otherwise available. The Fannie Mae forward commitment exception does not require lower rates. In various cases, such as the market today, simply having a guaranteed source of financing for home purchasers is a benefit to the purchasers. Of course, the “terms of the commitment” could include better rate and point combinations.

Good Faith Estimate

In NAHB’s comment letter to HUD on the 2002 RESPA proposal, we raised our concerns relating to the special circumstances involved in processing mortgages for newly built homes: “Originating mortgages for the purchase of newly constructed homes; which typically commences at the start of a construction period of four to nine months or longer, requires special attention.”⁶

NAHB’s 2002 comment letter describes the ways in which HUD’s earlier proposal failed to recognize or accommodate situations where the price of a newly built home may change many times while the home buyer goes through the process of selecting options for the home. A home buyer’s credit situation also may change for the better or worse during the construction period, which could change the purchaser’s mortgage financing options, including, but not limited to, the rate and terms of loans for which a purchaser may qualify. In the current proposal, it appears that HUD has once again failed to recognize these factors which are unique to new construction.

HUD’s proposal seeks to restrict changes in the GFE that occur within sixty days of the loan closing only to those changes that have occurred as a result of “unforeseeable circumstances.” Clearly, numerous changes in the price of a new home that result from selections of options can and do occur, sometimes until a few days before the sale is closed. Such changes are material and are not unforeseen; however, these changes would require the lender to issue a new GFE. In addition, a change in the sale price of a home may change other related costs, such as recordation- and title-associated fees and expenses, and might even require changes in the terms of the buyer’s loan.

The general rules HUD has proposed regarding the GFE do not mandate a minimum period of time that a GFE must be issued before settlement dates. Thus, mandating a sixty-day period under the new home exception is not warranted.

⁶ National Association of Home Builders comment letter, Docket No. FR-4727-P-01, October 28, 2002, page 2.

Furthermore, in a new construction home purchase scenario, it may not be possible to ascertain with precision the closing date for the sale. For example, if a lender issued a revised GFE sixty days in advance of an anticipated closing, and the home was completed several days ahead of schedule, therefore allowing the loan to be closed earlier than originally anticipated, the GFE would no longer be in compliance with HUD's proposed GFE requirements.

NAHB recommends that HUD either reduce the GFE sixty-day window to a more reasonable timeframe (and in no event greater than 14 days) or offer a broader exception for situations that involve the purchase of a newly built home to account for the greater potential for variations in such transaction than in transactions involving the sales of existing homes. NAHB also recommends that if a minimum period is established, that the period be based on the anticipated settlement date at the time the GFE is issued, and not the actual settlement date.

Conclusion

In conclusion, NAHB supports efforts to make the process of shopping for and obtaining a mortgage more transparent, straightforward and less expensive for consumers. However, NAHB disagrees with several aspects of the regulatory changes HUD has proposed to accomplish these goals.

We do not believe that HUD's analysis supports the conclusion that home builders should be prohibited from offering consumers the option to realize cost savings and other benefits that accrue through consumers' use of builders' affiliated mortgage and title companies. In its comments to HUD, NAHB has offered an alternative to the proposed definition of required use, which if adopted, would permit home builders to continue to offer *bona fide* and reasonable incentives in exchange for consumers' use of affiliated companies. Prohibiting such incentives would result in significant increases in home purchase costs and undermine critical financing support at a time of severe mortgage and housing market turbulence.

NAHB also is concerned that the proposed timing and restrictions regarding the Good Faith Estimate do not account for situations involving newly built homes and urges HUD to reconsider its proposal in this regard.

In closing, Mr. Chairman, I want to reiterate NAHB's opposition to HUD's proposed definition of "required use." I would welcome any questions you may have.