COMMENTS

to the

Department of Veterans Affairs

regarding

38 CFR Part 36

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Loan Guaranty: Revisions to Allowable Charges and Fees Assessed Incident to VA-Guaranteed Home Loans

by the

National Consumer Law Center,
on behalf of its low income clients,

the National Housing Law Project, the Connecticut Fair Housing Center, volunteer attorneys with the Missouri Bar VA Legal Clinic, and the National Association of Consumer Advocates

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The National Consumer Law Center, on behalf of its low-income clients, along with the National Housing Law Project, the Connecticut Fair Housing Center, volunteer attorneys with the Missouri Bar VA Legal Clinic and the National Association of Consumer Advocates, submits these comments in response to the Department of Veterans Affairs (VA) Loan Guaranty Service's request for comments on potentially changing the regulations governing the expenses a veteran may pay or be charged when obtaining a VA-guaranteed home loan.

Summary: The current restrictions on closing costs serve borrowers well and they should not be changed.

Based on our substantial experience protecting consumer mortgage borrowers, we strongly discourage VA from changing the regulations in question.

1. Introduction

The VA loan program exists to protect veterans on their road to homeownership. For that reason it is appropriate to adopt rules that prevent veterans from being overcharged. This has been the intent of Congress since the VA loan program was first created. VA has long had rules in place governing the fees veterans may be charged when originating a VA loan. Although the Federal Register notice mentions some complaints about these rules,[1] we are not aware of any widespread problems or evidence that the existing limits harm veterans. Instead, the limited data on VA loans suggest that the loan guarantee program remains popular, safe, and a good bargain for veterans.

2. Overview of the VA home loan guarantee program and its fee limitations

The VA home loan guarantee program is an immeasurably valuable benefit to veterans. The program encourages safe

[1] 82 Fed. Reg. 17792 (Apr. 13, 2017).

lending to veterans by offering to protect private lenders from the risk of borrower nonpayment. To participate in the program, both lenders and veterans must meet certain qualifications specified by law, regulations, and the VA Lenders Handbook.[2] Among the qualifications are restrictions on the loan terms, the lender's underwriting procedures, and the charges "made against, or paid by, the borrower incident to the making of a [VA] loan . . . ."[3]

VA regulations limit the fees that the veterans can pay to obtain a loan. The permitted fees fall into three general categories: the VA Funding fee (which is paid to VA and not discussed in these comments), a list of itemized fees, and a one-percent flat fee.

According to the Lenders Handbook the veteran may pay the following itemized fees "in amounts that are reasonable and customary":[4]

- appraisal and compliance inspection fees
- recording fees
- a fee for a credit report
- taxes and insurance
- a flood zone determination fee
- a fee for a survey
- a title examination fee and title insurance

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[2] VA Pamphlet 26-7, available at http://benefits.va.gov/warms/pam26_7.asp

[3] 38 C.F.R. § 36.4313(a).

[4] VA Pamphlet 26-7 at 8-3. The Handbook says "VA regulations in 38 CFR 36.4312 provide the list of fees and charges that the veteran can pay." *Id.* The reference to § 36.4312 appears to be a typo as that section currently refers to interest rates. Section 36.4313 sets forth the current limits on charges and fees.

- an express mail fee (for refinancing loans only in limited circumstances)
- a MERS fee, and
- certain other fees specifically authorized by VA Regional Loan Centers.[5]

The one-percent flat fee is permitted in addition to the itemized fees. There are no stated limits on what it may be applied to,[6] and the lender is not required to explain where the flat fee goes. According to VA, it "is intended to cover **all** the lender's costs and services which are not reimbursable as itemized fees and charges."[7] While not expressly stated in the law, regulations, or handbook, lenders may also recoup their expenses from the interest paid by the veteran over the life of the loan. This is traditional for all mortgages.

2.1 Protecting veterans has always been a central goal of the VA loan guarantee program.

The VA loan program was first authorized at the end of World War II as part of broader legislation to help returning servicemembers readjust to society. Despite many changes since the program began in 1944, the legislative record shows that Congress has consistently intended the program to help protect veterans from abusive lending practices and unsafe housing.[8] As one Senator explained in 1944, one of the basic

[5] For example, in California borrowers may pay to have a house inspected for wood-destroying insects, and in Arkansas borrowers may pay $25 for a closing protection letter.

[6] Except that the lender must still comply with the Real Estate Settlement Procedures Act. VA Pamphlet 26-7 at 8-9.

[7] *Id.* (emphasis in original, internal quotation marks omitted).

[8] Economic Systems Inc., ORC Macro, and The Hay Group, Evaluation of VA's Home Loan Guaranty Program at C-110 (July 2004) (VA commissioned study analyzing legislative history and concluding "Congress has exercised stewardship over the benefit by raising protections against substandard construction and unfair appraisal and lending practices. Congress has also delayed

goals of the original legislation was "to throw every possible protection about the veteran, to bridge the awkward gap between the release from the armed services and reintegration into civilian life."[9]

As more recently stated in VA's Lenders Handbook, "[t]he VA Home Loan program involves a veteran's benefit. VA policy has evolved around the objective of helping the veteran to use his or her home loan benefit. Therefore, VA regulations limit the fees that the veteran can pay to obtain a loan."[10]

2.2 Statistics show how well the VA loan guarantee program serves veterans.

The protections built into the VA loan guarantee program have served veterans well. VA has guaranteed over 20 million loans since 1944.[11] And homeownership is more common among veterans than among non-veterans.[12] Delinquency and foreclosure rates for VA loans have consistently been lower than for FHA loans[13] (the program to which VA loans are most

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incorporation of new financing methods until it could be assured they posed no potential harm for veterans.")

9 Sen. Clark, Congressional Record—Appendix, June 12, 1944, p. A3197.

10 VA Pamphlet 26-7 at 8-2.

11 Dep't of Veterans Affairs, Press Release, VA Guarantees 20 Millionth Home Loan (Oct. 26, 2012).

12 Veteran Ownership Outpaces Non-Veterans, Economists' Outlook Blog, Nat'l Ass'n of Realtors (Jan. 7, 2016) (showing consistently higher homeownership rate for veterans from 2005 to 2014), available at https://web.archive.org/web/20160108073224/http://economistsoutlook.blogs.realtor.org/2016/01/07/veteran-ownership-outpaces-non-veterans/.

13 Laurie Goodman, Ellen Seidman, and Jun Zhu, The Urban Institute, VA Loans Outperform FHA Loans. Why? And What Can We Learn? at 1, 6 (July 2014).

often compared) and conventional loans.[14] Interest rates on VA loans are also consistently lower than on other mortgages.[15]

While there are likely many reasons for these differences, these numbers indicate that the VA loan program is working well. In particular, from the available statistics regarding VA loans, there is no evidence that veterans are harmed by the existing restrictions on closing costs.

Instead, recent statistics suggest that VA loans are becoming more popular. One report found that, in 2014, VA loans were nearly nine percent of all mortgage lending activity--an increase from less than two percent in 2005.[16] In 2014 VA lenders reported approximately $112 billion of VA loan activity. From 2012 to 2014 the program guaranteed over half a million loans per year "and has been a beacon of hope during tough economic times."[17]

The VA loan program has been especially important for minority veterans, comprising 18 percent of all African American loan originations and 13 percent of loans to American Indian/Alaska Natives.[18] Significantly, the difference between loan origination and denial rates for whites and African American borrowers is lower for VA loans than for

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[14] Dep't of Veterans Affairs, Press Release, VA's Home Loan Program Continues to Lead Mortgage Industry (Jan. 30, 2012).

[15] The Mortgage Reports, VA Mortgage Rates: Lowest For 36 Straight Months (graphic using data from May 2014 to April 2017 from Ellie Mae), available at https://themortgagereports.com/28556/ellie-mae-va-mortgage-rates-april-2017.

[16] Christina Davila and Keith Wiley, Soldier's Home: A Closer Look at the Department of Veteran Affairs' (VA) Home Loan Program, Housing Assistance Council at 9 (Dec. 2016) (hereinafter "Soldier's Home").

[17] *Id.* at at 29.

[18] *Id.* at 18.

conventional mortgages.[19] While the reasons for this difference have not been established, we believe that VA's limits on closing costs reduce the risk of discrimination in discretionary pricing.

2.3 Gradual changes in the VA program have made the fee limitations more important.

Since 1954 when VA adopted the existing system of controlling fees, changes in federal law and VA practices have exposed veterans to greater risk and the potential for higher costs. These changes make the limits on closing costs particularly important.

- For years federal law capped the interest rate on VA loans. But Congress gradually raised the rate cap until 1996 when the cap was finally abolished.[20]
- In 1974 Congress voted to extend loan approval authority to unsupervised lenders.[21] Unsupervised lenders are not subject to examination or supervision by

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[19] *Id.* at 18-19.

[20] *See* Pub.L. 85–364 (April 1, 1958) (raising cap from 4.5% to 4.75%; Pub.L. 86–73 (June 30, 1959) (raising cap to 5.25%); Pub.L.. 89–358 (March 3, 1966) (permiting VA to set interest rate so long as VA rate did not exceed rate established for FHA loans); Pub.L.. 90–301 (May 7, 1968) (relaxing limit on FHA rate cap, giving HUD authority to set FHA loans at any level needed to meet mortgage market, thereby giving VA further power to raise rates); Pub.L.. 94–324 (June 30, 1976) (preempting, under certain conditions, state usury laws and provisions limiting the maximum interest rate on mortgage loans); Pub.L.. 102–547 (October 28, 1992) (established test program eliminating caps on interest rates for VA loans); Pub.L.. 104–110 (February 13, 1996) (permanently eliminating cap on interest rates by giving VA authority to guarantee loans on which the veteran negotiated rate and to include discount points in the loan amount).

[21] Pub.L.. 93–569; House of Representatives, The Veterans' Housing Act of 1974, 93rd Congress, 2nd Session, Report No. 93–1232, July 29, 1974, p. 2.

federal or state bank regulators.[22] This means they are less regulated and their customers less protected.

- Over time, VA has expanded use of automatic approval authority so much that it has almost entirely transferred to lenders its authority to approve loans. While VA originally underwrote loans, Congress and VA have gradually delegated that responsibility to lenders. As of 2004, lenders use their automatic approval authority to underwrite and approve approximately 99 percent of loans with limited VA involvement—up from about 92 percent in the 1990s and 45 percent in the 1980s.[23]

While these changes may have some benefits for veterans, they also increase each veteran's exposure to the risks of market forces. Without VA's rules for closing costs, the cost of closing a loan will almost certainly go up without any corresponding benefit to veterans.

3. Response to VA's Questions

3.1 Question 1: What are ways that VA can protect veterans from incurring excessive closing costs, without being overly restrictive?

The current system works, and we see no reason to change it. The current limits on closing costs are, in fact, very flexible: The lender may charge anything it wants as long as fees not included in the itemized list do not total more than one percent of the loan.[24] In addition, the current rules allow

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[22] House of Representatives, Explanation of Public Law 268, 79th Congress, Committee Print No. 119, p. 4.

[23] Economic Systems Inc., ORC Macro, and The Hay Group, Evaluation of VA's Home Loan Guaranty Program at 46 (July 2004)

[24] *See* VA Pamphlet 26-7 at 8-5-8.7. We note that in the "Background" section of the Agency's Advanced Notice of Proposed Rulemaking, this flat charge by the lender is described as an alternative option "in lieu of" charging for the permissible items listed in the schedule. That is not correct. Under the current rules, the lender is permitted to charge up to one percent of the loan to

lenders to obtain local variances for the inclusion of additional closing costs based on regional custom and practice.[25] This safety valve permits lenders in Virginia and West Virginia, for example, to directly pass along the cost of title examinations to borrowers instead of absorbing the cost in the lender's one percent origination fee.[26] VA has also granted a variance for pest inspection charges to lenders in seven states and two territories.[27]

Lenders that wish to charge more can do so by increasing the interest rate on the loan and recouping their costs from the interest paid each month. Because the rates on VA loans are usually lower than the rates on other mortgages, VA lenders would not be at a competitive disadvantage by doing so. And veterans would still be protected from unfair charges.

Lenders may also offer so-called "no-cost loans," in which the lender agrees not to charge any closing costs in return for a higher interest rate.[28] Instead of having the borrower pay cash for the closing costs or borrow more money, the lender in a no-cost loan absorbs the closing costs (sometimes by applying a credit on the settlement statement) and recoups

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cover "all *other* charges relating to costs of origination *not* expressly specified and allowed" in the schedule. 38 C.F.R. § 36.4313(2) (emphasis added).

[25] 38 C.F.R. § 36.4313(d)(1)(ix)

[26] *See* VA State and Territory Fees and Charges Deviations Table, Current through May 23, 2017, available at http://benefits.va.gov/homeloans/documents/docs/state_deviations.pdf

[27] *Id*.

[28] The term "no-cost" is actually a misnomer because the costs are paid through the interest rate. But that is the term widely used in the mortgage industry. A better name may be "no upfront closing costs."

the expense through the increased interest rate.[29] While some say no-cost loans are financially disadvantageous for borrowers who plan to keep the same loan for a significant time period,[30] those calculations do not take into account other benefits.

No-cost loans allow borrowers to apply their cash savings directly to a down payment on the loan. They also protect borrowers from discrimination because overcharges based on race and income appear to be far less likely with no-cost loans.[31]

No-cost loans also save borrowers money by making loan shopping considerably easier.[32] Rather than comparing the interest rate plus a multiplicity of closing costs, the borrower need only compare the interest rate across loans (assuming they are all no-cost loans with fixed interest rates and the same maturity dates). Also, because the lender in a no-cost loan bears the risk of markups and other deceptive settlement charges, paying all the costs through the rate can reduce risk of settlement service providers gouging the borrower. One

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[29] *See* The Mortgage Professor: No-Cost Mortgages (Feb. 7, 2012), available at www.mtgprofessor.com/a%20-%20options/no-cost_mortgages.htm (describing no-cost loans).

[30] *See* Lynnley Browning, The Price of a 'No-Cost' Loan, N.Y. Times, Oct. 22, 2010, available at www.nytimes.com/2010/10/24/realestate/24mort.html (warning of risks of no-cost loans).

[31] Susan E. Woodward, A Study of Closing Costs for FHA Mortgages 70 (May 2008) (prepared for U.S. Dep't of Housing and Urban Development), available at http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf

[32] *See* Susan E. Woodward and Robert E. Hall, Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence, 107 American Economic Review 3249, 3275 (2012) (finding a "single-dimension shopping strategy based on the no-cost loan" to offer a "striking advantage" for borrowers).

analysis of FHA loans found that borrowers with no-cost loans saved $1,200 in origination fees compared to borrowers who pay closing costs in cash.[33]

But regardless of whether a no-cost loan is the best option for a particular borrower, the point here is that it gives the lender another measure of flexibility, and is another reason not to change the current limits.

3.2 Question 2: Under the current rule, VA distinguishes between a "fee" and a "charge" but does not define the terms. Should VA eliminate the distinction? If not, how should VA define the terms?

The use of the phrase "fees and charges" in the current regulation and the Lender's Handbook suggests that VA is distinguishing between these types of expenses. But the two terms are not consistently used to refer to different types of expenses and are in fact used interchangeably in some instances. Even though the current usage is somewhat haphazard, because the specific expenses permitted to be charged to a borrower are enumerated and other expenses that may not be charged to a borrower are identified specifically, the somewhat imprecise usage of these terms does not, in our view, create a risk to borrowers. If VA were starting from scratch with an entirely new set of regulations for its lending programs, we would recommend using just one term (such as "charge" or "expense") to cover all closing-related items and including a definition of the term used. Given that the current usage is not causing problems and that trying to define the terms as currently used might create new confusion, we discourage making any changes in this regard.

3.3 Question 3: Does the term "origination fee" accurately reflect what a borrower would pay to a

[33] Susan E. Woodward, A Study of Closing Costs for FHA Mortgages xi, 70 (May 2008) (prepared for U.S. Dep't of Housing and Urban Development) (finding "the terms on no-cost loans are substantially better than the terms on other loans."), available at http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf.

lender in order to originate a loan? What do veterans and lenders view as the purpose of an origination fee?

The basis for this question is not entirely clear since neither the regulation nor the Lender Handbook uses the term "origination fee." That said, consumer advocates who work directly with borrowers generally refer to a lender charge that relates to the underwriting and processing of a loan application as an "origination fee" and distinguish that fee from other standard closing-related costs charged by third parties such as appraisals, recording fees and title insurance. In the context of VA loans, the charges lenders are permitted to assess to veterans over and above the permissible third-party fees and charges pursuant to 8 C.F.R. § 36.4313(2) are understood to compensate the lender for its services in underwriting and processing the application as well as to cover some or all of the additional third-party expenses incurred in the transaction. Generally borrowers also understand that the lender is profiting from the interest the borrower pays during the life of the loan.

3.4 Question 4: How should VA identify which closing costs are acceptable for the veteran to pay, which are acceptable for another party but not a veteran to pay, and which, if any, should be prohibited?

As noted above, the current system has been functioning well for several decades now, so we see no need to come up with an alternative model. If, however, VA is considering adding or deleting certain items from one of these categories, we urge that the analysis be based on actual data reflecting real market conditions. Due to variations in loan closing practices and requirements across different jurisdictions, we believe the best way to proceed is to maintain VA's current policy of reviewing deviation requests on an individual basis. As discussed below in our response to Question 6,[34] deviations from the national standard should only be granted based on clear documentation.

[34] *See* § 3.6.

3.5 Question 5: To what extent, if at all, should VA limit third-party charges or fees to the actual costs of the service provided? Alternatively, should VA permit borrowers, sellers, and lenders to negotiate their own bargains?

There is no justification for charging borrowers more than the actual cost of the service provided. Allowing service providers to do so will lead to hidden markups and price gouging. The typical borrower does not have the expertise or leverage needed to negotiate fixed or standard fees with professionals and repeat players. Suggesting otherwise ignores the realities of the marketplace.[35] Therefore, VA should not allow third-party fees in excess of the actual costs of the services provided.

3.6 Question 6: To what extent, if at all, should local real estate customs affect (i) the types and amounts of closing costs that VA allows and (ii) which party is responsible for paying such costs?

There are legitimate regional differences in loan closing practices, and we agree that VA may safely make some exceptions for these variations. But any exceptions must be based on evidence that they are unavoidable. And the exception must be clearly documented.

VA already has a procedure for allowing fees that are normally not permitted. A list of approved charge deviations is available on VA's website.[36] The only alternative to the existing system would be to allow lenders and servicer

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[35] *See, e.g.,* Ben Lane, HousingWire, [Study] Americans shop around for everything but mortgages (Oct. 12, 2015) (study finding consumers more likely to bargain hunt for gas than a loan), available at https://www.housingwire.com/articles/35322-study-americans-shop-around-for-everything-but-mortgages; Shelley Smith, Reforming the Law of Adhesion Contracts: A Judicial Response to the Subprime Mortgage Crisis, 14 Lewis & Clark L. Rev. 1035 (2010).

[36] http://www.benefits.va.gov/homeloans/documents/docs/state_deviations.pdf

providers to decide what they consider "normal" or "customary." Such a policy would be too vague and would put the burden on the veteran to challenge any inappropriate fees. Nor does VA have the resources to review the closing costs charged on each loan. In contrast, the current system of pre-authorized deviations enables the lending industry to use its vast resources and broad experience to prove when an exception is necessary.

3.7 Question 8: Should VA allow lenders to charge veterans differently depending upon the type of transaction (e.g., purchase, cash-out refinance, streamlined refinance, etc.)? If so, what are the justifications for the different pricing?

The only permissible justification for different pricing should the actual and documented cost of the transaction. A lack of transparency in pricing inhibits shopping and facilitates illegal discrimination.[37] Different pricing should only be allowed where the need is clear and well documented by actual data.

3.8 Question 9: What other lending programs, whether public or private, might VA consider as models in considering amendments to VA's charges and fees rule? What characteristics make these programs useful analogs to the VA-guaranteed loan program?

The VA loan program is the model that we use when urging changes to all other loan programs. It is the lowest cost,

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[37] *See* Susan E. Woodward, A Study of Closing Costs for FHA Mortgages U.S. Dep't of Hous. and Urban Development, Offc. of Policy Development and Research xiii (May 2008) (finding "[m]inority borrowers and borrowers in minority neighborhoods and neighborhoods with lower educational attainment consistently pay higher fees, other things being equal. These variations suggest that markets are not fully transparent or competitive." and "[c]omplicated loan arrangements raise the total costs to homebuyers and increase the variability of fees, suggesting that lenders and brokers in particular profit when transactions are complex and consumers have a harder time comparing alternatives.").

most transparent loan product available. A veteran can largely trust an approved VA lender but must view all other loan transactions as an adversarial relationship.

3.9 Question 10: What other information should VA consider in determining the types of expenses a veteran should be expected to pay to close a VA-guaranteed loan?

If VA decides to consider changes, it should obtain data on the actual closing costs charged in a wide range of loans (conventional, FHA, VA, and USDA). The data should indicate whether the fees were financed or paid in cash. And the fees should be disaggregated--not merely hidden in the total of closing costs. Each fee should be coded to determine whether it was required by law and whether it was paid to a third party. In addition, VA's analysis should include the interest rate on each loan, whether the borrower defaulted, and all data collected pursuant to the Home Mortgage Disclosure Act (HMDA).

Without all of this data, VA will be unable to properly evaluate the impact of adding to or changing the list of permissible closing costs.

Appendix of Signatories

The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including *Mortgage Lending*, *Foreclosures & Mortgage Servicing*, and *Truth in Lending*.

These comments were written by NCLC attorney Andrew G. Pizor and NHLP attorney Lisa Sitkin.

The **National Housing Law Project** (NHLP) is a law and advocacy center established in 1968. For nearly 50 years, NHLP has been dedicated to advancing housing justice for the poor by using the power of the law to increase and preserve the supply of decent affordable housing, to improve existing housing conditions, including physical conditions and management practices, to expand and enforce low-income tenants' and homeowners' rights, and to increase opportunities for racial and ethnic minorities.

The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

The **Missouri Bar VA Legal Clinic** volunteer attorneys are David Angle and Matt Wilson of Angle Wilson Law, LLC of Columbia, Missouri.

Since 1994, the **Connecticut Fair Housing Center** has provided investigative and legal services to residents who believe they have been the victims of housing discrimination. The Center also has provided education and conducted outreach on fair housing and fair lending issues throughout Connecticut. In addition, the Center has worked with the State of Connecticut, cities, towns, housing developers, housing managers, and others to promote compliance with federal fair housing laws.