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Real Estate

Mortgage Brokers And Lenders

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BORROWERS are often told that going to a mortgage broker is a no-lose proposition. The broker's fee, the reasoning goes, is more than justified by the broker's ability to get a loan at a lower interest rate than the customer could get on his own. And usually that's the case.

But while brokers may often get better deals for their borrowers, they don't always get the best deal.

In fact, brokers have a financial incentive not to get the best possible deal for borrowers, because of a practice called yield spread premium pricing. Yield spread premiums are payments brokers receive from many lenders for arranging loans with a higher interest rate than the lender is prepared to accept — terms somewhere between the wholesale rate lenders offer brokers and the retail rate available to direct customers.

"A lot of brokers are making a lot of money on yield spread premiums," said Richard J. Russell, president of Richland Equity Resources, a Manhattan mortgage broker. "It's legal as long as it's disclosed. But this is all about disclosure."

Mortgage brokers get better rates, he said, because they prepare the paperwork and deal in volume with lenders. For example, a borrower who goes directly to a lender might obtain a $150,000, 30-year fixed-rate mortgage at 8 percent with the payment of one point — one percent of the mortgage amount — to the lender.

If that borrower went through a mortgage broker, he might get the same mortgage at 7.5 percent by paying one point to the broker instead of the lender.

The benefit to the customer would be one-half of a percentage point in interest — a difference of more than $100 a month in mortgage payments and more than $18,000 over the life of the loan.

But if the broker negotiated the mortgage at 7.75 percent — plus the point to the broker — instead of 7.50 percent, making it more valuable to the lender, the lender may compensate the broker with a yield spread premium. And while the amount of the payment varies from lender to lender, it would not be unusual, Mr. Russell said, , for a broker to be paid one or more points for delivering such a loan to a lender.

The customer gets a lower interest rate than he would have if he had gone to the bank directly, the lender gets a higher rate and the broker gets more money. So everybody wins, right? Well, not exactly.

"It is ludicrous to believe that any fully informed borrower would pay a mortgage broker for any other purpose than to obtain a loan on the best terms possible," said John G. Hall, a Staten Island lawyer who is chairman of the Real Property Section of the New York State Bar Association.

Mr. Hall said that whenever a broker gets a yield spread premium from a lender, it's a good bet the broker's customer is not getting a loan on the best terms. In New York, he said, brokers must disclose in writing and at the time of application that they may be paid a fee by the lender in the form of a yield spread premium. (Such fees are generally expressed in points or fractions of a point, again representing a percentage of the loan itself.) Just making that disclosure, however, provides little useful information to the customer.

"The broker tells the customer: 'You don't have to worry because you're only paying one point; the rest are being paid by the lender,' " Mr. Hall said, adding that the broker often doesn't disclose that to receive those extra points, he must deliver a loan at terms more favorable to the lender than the lender would otherwise require. "Even with adequate disclosure," he said, "consumers cannot be expected to be savvy enough to know that the broker is not working in their best interest."

In most cases, Mr. Hall said, the amount the broker is being paid will usually not be known until the lender issues the mortgage commitment. At that point it is too late for the borrower to do anything. "What do you do?" Mr. Hall said. "Apply to another lender with only two days left on your mortgage contingency and 15 days left until closing?"

Most borrowers, he said, simply go through with the deal without fully realizing the impact a yield spread premium may have had on their interest rate. And even when a specific reference to a yield spread premium is noted on the closing statement, the reference is still unlikely to be understood by many borrowers. Mr. Hall said that a typical reference on a HUD-1 form — the closing statement required by the Department of Housing and Urban Development under the Real Estate Settlement Procedures Act — might read: "YSP paid from Lender to Great Mortgage Brokerage Corp. — $2,000 P.O.C."

The term "P.O.C.," Mr. Hall said, refers to a payment made "outside of closing." Since such payments have no effect on the amount the borrower has to bring to the closing, they are often ignored.

Eric Gonchar, a Manhattan real estate lawyer, said that in his experience, most deals involving brokers also involve yield spread premiums.

"It's on almost every HUD-1 that we do," Mr. Gonchar said, adding that the payment of such premiums has become a hot topic in the mortgage industry as the result of a ruling by a United States District Judge in a Virginia case earlier this year.

The judge ruled that the payment of yield spread premiums violates the Real Estate Settlement Procedures Act because such payments are not compensation — which is permitted under the act — but are referral fees — which are prohibited. The ruling, now being appealed, is the first to question the legality of yield spread premiums. Mortgage industry experts, however, view the case as an anomaly and expect it to be reversed on appeal.

"Yield spread premiums are nothing more than a payment by a lender to a broker for the services rendered by that broker," said E. Robert Levy, executive director of the Mortgage Bankers Association of New Jersey, a trade organization in Springfield.

In fact, he said, yield spread premiums are what make it possible for brokers to arrange "zero-point" loans for cash-strapped borrowers. In such cases, he said, the borrowers accept a mortgage with an interest rate that is higher than the current market rate. Doing so enables the lender to pay the broker a yield spread premium of several points, thereby making it unnecessary for the broker to charge the borrower.

"If starting tomorrow, there were no more yield spread premiums," Mr. Levy said, "there would be no more zero-point loans either."