**Mortgage Lenders, REALTORS® and RESPA**

While it may be hard to just say “no” to the freebies that mortgage lenders sometimes offer REALTORS® for the referral of loan business, just saying “no” is clearly the best way to avoid running afoul of the Real Estate Settlement and Procedures Act ("RESPA"). RESPA may be the least understood and the most violated real estate law in the country. The broad prohibitions of the law cover many practices, including some practices, which are, unfortunately, engaged in by real estate brokers. While the law is strict, ambiguities in RESPA lend to the law being blatantly violated by covered individuals. Moreover, RESPA was not aggressively enforced for many years and covered individuals were essentially left to “self-police” their conduct and practices. For obvious reasons, this system did not work well and abuses naturally followed. However, violations carry a high price because RESPA provides for both criminal and civil penalties and subjects the violator to lawsuits seeking treble damages.

In recent years, the Department of Housing and Urban Development (HUD) has made it clear that it takes violations of RESPA, specifically the anti-kickback and prohibition against unearned referral fees, very seriously. For example, in November 2001, HUD announced forty-two settlements it had reached resulting in over $2.25 million in payments for alleged violations involving illegal kickbacks and referrals. HUD will not shy away from listing the names of the parties and amounts of payments on their Web site to discourage other violators from continuing to engage in illegal behavior. HUD’s enforcement crackdown for RESPA violations has continued over recent years and some
Georgia-based settlement services providers have been slapped with penalties. GAR has recently received word of a possible crackdown on illegal practices involving mortgage lenders and REALTORS® in violation of RESPA. As a result, GAR is issuing this white paper on RESPA to help educate REALTORS® on how to comply with the law.

Compliance with most of the RESPA requirements is simple, so long as the professional is alert and aware of the general rules. The best way for real estate professionals to avoid problems with RESPA is to follow one simple rule - pay your own way, expect others to do the same, and refer business based on the quality of the service provided rather than personal gain. Since RESPA is very complex and any one factor can influence the interpretation of the relevant provisions, professionals may sometimes find it necessary or appropriate to seek the advice of legal counsel, particularly when settlement service providers redesign their programs or practices. Set forth below are answers to some of the most commonly asked questions about RESPA.

WHAT IS RESPA?

Congress enacted RESPA in 1974 to ensure that consumers receive greater and more timely information on the nature and costs of the real estate settlement process and are protected from unnecessarily high costs associated with real estate closings. RESPA attempts to protect borrowers by prohibiting individuals who provide services related to real estate closings from paying one another kickbacks or referral fees, especially hidden or “under the table” kickbacks and referral fees. The idea behind the law is that eliminating such
payments will help keep closing costs down for borrowers. A RESPA violation subjects a person to a fine of up to $10,000 for each offense, imprisonment of up to one year, or both. In addition, the violator may also be liable to the person who was charged for the settlement service (i.e., the buyer or seller) for an amount equal to three times the amount paid for the settlement service. The RESPA statute can be found at 12 U.S.C. § 2601, et seq. HUD is charged with enforcing the law. HUD is also empowered with drafting regulations to clarify what is permitted under the law. The regulations issued by HUD, which implement RESPA, are known as Regulation X.

The key language in RESPA is in Section 8, which provides two basic rules of prohibition. First, Section 8(a) prohibits the transfer of a thing of value pursuant to an understanding that business will be referred to any person. It states:

“No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.”

Second, Section 8(b) prohibits the splitting of any charge made or received for the performance of a settlement service except for services actually performed. It states:

“No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.”
RESPA was written very broadly. Hence there are many “gray” areas in this area of the law, making generalizations difficult and risky. A basic understanding of the law and following the letter of its exceptions can help to skirt some potential violations.

WHAT IS A SETTLEMENT SERVICE, AND WHO ARE SETTLEMENT SERVICE PROVIDERS?

A violation of Section 8 must somehow involve a “settlement service” in connection with the closing of a “federally related mortgage loan.” “Settlement service” has a broad meaning and includes most if not all services that are performed prior to or in connection with a residential real estate closing. “Settlement service providers” include attorneys, appraisers, surveyors, credit reporting agencies, insurance companies, real estate brokers and salespersons, title insurance companies, mortgage bankers and brokers, home inspectors, pest and fungus inspectors, and even home warranty companies. “Federally related mortgage loans” include most first mortgage loans secured by single-family residential properties.

CAN A REALTOR® RECEIVE A GIFT, PRIZE, OR FEE FROM A LENDER, CLOSING ATTORNEY, OR OTHER SETTLEMENT SERVICE PROVIDER?

Section 8(a) of RESPA prohibits the giving or accepting of a “thing of value” to another person for the referral of settlement business. RESPA uses the term a “thing of value” very broadly to include in its prohibition all imaginable forms of compensation for a referral. Section 3 of RESPA defines a “thing of value” to include, among other things, money, services, discounts, commissions, and even the opportunity to participate in a money-making program. As a result, REALTORS® cannot receive gifts, prizes, fees, or kickbacks (even if they are
disclosed) for the referral of business to other settlement service providers. It would be a violation of RESPA for a lender to pay for a hotel room, buy an expensive gift, present a gift certificate, etc. in return for the REALTOR® referring business to a mortgage lender, closing attorney, home inspector or any other settlement services provider. Payment of a thing of value does not require transfer of money. Any type of consideration that has value to the recipient is covered. Even giving a person the opportunity for a chance to win a trip or some other prize in exchange for the referral of business is considered a thing of value. Therefore, for example, a mortgage lender may not set up a contest for real estate agents under which the agent who provides the mortgage lender with the most business will win a trip to Hawaii. Even a referral in expectation of a referral back can be considered a thing of value. For example, a mortgage lender who refers business to a real estate broker in anticipation of the referral of closing business to an employee of the mortgage broker would likely be found to have violated RESPA. It is a violation of RESPA for REALTORS® to receive a thing of value, even if the referral agreement is informal and not in writing.

An exception to RESPA permits the payment of referral fees between real estate brokers when such payments are made “pursuant to a cooperative brokerage arrangement or agreements between real estate agents and brokers.” Therefore, a REALTOR® can lawfully pay another REALTOR® a referral fee in situations, for example, where there is a dispute over whether the selling broker is entitled to a commission. While referral fees among real estate brokers are exempt under RESPA, a REALTOR® could not, for example, accept a referral
fee from another REALTOR® who also happens to be a mortgage lender for the referral of mortgage business.

CAN A REALTOR® LEASE OFFICE SPACE TO A MORTGAGE LENDER, ATTORNEY, OR OTHER SETTLEMENT SERVICE PROVIDER FOR HIGHER THAN MARKET RATES?

Section 3(2) of RESPA specifically defines a thing of value to include “lease or rental payments based in whole or in part on the amount of business referred….” Real estate offices that lease desk or office space to settlement providers must charge the general market value for the space leased. The value of a referral (i.e., of any additional business obtained from the lessor) cannot be considered in determining whether there is a reasonable relationship between the rental payments and the facilities provided. Where a settlement provider is paying higher than market rates to a real estate office for leased space, a presumption that such rental payments represent disguised referral fees is raised. In evaluating whether high rental payments constitute a violation of RESPA, HUD applies the following test:

If the payment [of rent] bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. The value of a referral is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods or services. (Section 3500.14(g)(2) of the regulations implementing RESPA).

In determining the fair market value of rental space, HUD looks at what a non-settlement service provider would pay for the same amount of space and services in the same or a comparable building as opposed to what a settlement service provider would pay for the office space. If the rental payments exceed the general market value of the space provided, then HUD will consider the excess
amount to be for the referral of business in violation of Section 8(a). This standard represents an attempt to remove the value of referrals from the determination of rent value.

HUD has also encountered “bogus” rental arrangements that are really agreements for the payment of referral fees. For example, one case involved a title insurance company that paid a “rental fee” to a real estate broker for the “per use rental” of a conference room for closings. The title insurance company paid a $100 fee for each transaction. This “rental fee” was greater than the general market value for the use of the space. In addition, the facts revealed that the room was rarely actually used for closings. In this case, HUD examined whether a “facility” was actually furnished at a general market rate and concluded that this was a sham rental arrangement. The “rent” was really a disguised referral fee in violation of Section 8(a).

Another RESPA concern associated with real estate brokers leasing office space involves a situation where a rental of desk or office space to a particular settlement service provider could lead to other, competing, settlement service providers being “locked-out” from access to the referrers of business or from reaching the consumer. HUD has concluded that a lock-out, by itself, does not constitute a RESPA violation. At the same time, however, the existence of a lock-out situation will likely increase the scrutiny that will be applied to other aspects of the arrangement, such as the amount of rent that is paid.
WHAT MARKETING ARRANGEMENTS CAN BE MADE BETWEEN A MORTGAGE LENDER AND A REALTOR®?

RESPA provides an exception to Section 8 related to payments for marketing or advertising. Specifically, under § 3500.14(g)(vi) of the regulations interpreting RESPA, settlement service providers are permitted to engage in:

[N]ormal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto.

While the payment of kickbacks and referral fees is illegal, HUD recognizes the right of settlement service providers to pay fair and reasonable fees for normal marketing and advertising efforts. For example, a lender providing real estate agents with note pads with the lender’s name on it would be allowable as normal promotional items. However, if the lender gives the real estate agent note pads with the real estate agents’ name on it for the agent to use to market clients for its real estate business, then the note pads could be a thing of value given for referral of loan business, because it defrays a marketing expense that the real estate agent would otherwise incur. Similarly, if a mortgage lender holds an educational program which is only open to REALTORS® who refer the mortgage lender business, it would be a RESPA violation. However, an educational program open to all REALTORS® in a particular office regardless of whether they referred business to the mortgage lender or not, would not be a violation of RESPA.

Also, nothing in RESPA prevents joint advertising. However, if one party is paying less than a pro-rata share for the brochure or advertisement, there could be a RESPA violation. There is a substantial risk of being found to have violated
RESPA if a REALTOR®, for example, solicits a lender or other settlement service provider to pay for all or most of the costs of a flyer if the advertisement prominently highlights the REALTOR® in the main body of the flyer and contains only a small acknowledgement of the lender at the bottom of the flyer. However, if the real estate company and the mortgage company share the expenses evenly and are both equally visible in their marketing efforts, there is likely no RESPA violation.

Another question that is frequently asked in the area is whether it is permissible for a mortgage lender to sponsor an agent’s luncheon at an open house without violating RESPA. An argument can be made that such an arrangement is lawful as a normal marketing expense of the mortgage lender since such a luncheon is a way for the mortgage lender to meet numerous other REALTORS® who might be a source of business referrals. However, such arrangements are suspect and may be a violation if the criteria used by the mortgage lender in selecting which luncheon to sponsor is whether the agent requesting the sponsorship refers a significant amount of business to the mortgage lender rather than whether the luncheon will expose the lender to the most agents.

The likelihood of an enforcement action being brought under RESPA as it relates to marketing arrangements between REALTORS® and lenders is greater today than at any time in the past. In fact, HUD is currently investigating marketing agreements between mortgage lenders and real estate brokerage firms. Therefore, the risks involved in this area must be fully understood to avoid
inadvertent violations of RESPA. The other type of marketing agreement between a mortgage lender and a real estate brokerage firm is one in which the lender agrees to pay the real estate broker a monthly or an annual fee (usually a very significant amount) in exchange for the broker assisting the lender in marketing various loan products and programs to the broker’s agents and customers. Under the application of the Section 8 exception, the key issue in this area is whether a specific payment made under a marketing agreement bears a reasonable relationship to the market value of the goods and services provided. While this may seem like a relatively straightforward issue, may REALTORS® have found the “devil to be in the details” in working through this issue. Clearly, it is a violation of federal law for a mortgage lender to simply pay a real estate broker a fee for the referral of settlement services business. But, if the payment is reasonable in light of the services and facilities being provided, the payment is considered a bona fide fee for services provided rather than an illegal payment for referral. Where the exact line is drawn in this area is often a function of conflicting expert opinions which the broker must balance against the amount of the payment and the degree of risk the broker is willing to take.

Although HUD has not provided significant guidance in determining how the reasonableness of a particular marketing fee is to be determined, in one interpretation HUD indicated that it might be appropriate to look to fees generally charged in the marketplace for the same services (assuming the value of any referral is not included), or to the internal cost of providing the service. In other words, if placing brochures of the lender in the lobby of the broker’s office results
in 25 prospective homebuyers getting a copy of the brochure, HUD might ask what it would cost to get such a brochure into the hands of 25 prospective homebuyers using other means of marketing. The greater the number of marketing services and facilities performed and provided by the real estate broker on behalf of a mortgage lender, the easier it is to justify the fee paid under the marketing agreement. Further, HUD examines the purpose of the fee in determining whether it is legal and has concluded that the payment of marketing costs “in a manner that does not bear on the amount of loan business referred” is permissible. The characterization of the purpose of the payments under a marketing arrangement generally depends on the formula for compensation. Basically, the payment should not be linked to the actual number of transactions that are generated by the arrangement. HUD has historically taken the position that fees that are not “transactionally-based,” (payable on a per loan basis for loans that actually close) are fair and reasonable. Therefore, a proposed marketing agreement that does not provide for transactionally-based compensation and the lender makes a fixed monthly or yearly payment at an amount fixed at the inception of the agreement likely will generally be viewed more positively by HUD.

**CAN A REALTOR® FORM A JOINT VENTURE WITH A MORTGAGE COMPANY OR ANOTHER SETTLEMENT SERVICE PROVIDER AS A WAY OF EARNING ADDITIONAL INCOME?**

An exemption under RESPA permits real estate brokers or agents to form a mortgage or title company, refer business to it and, as owners, reap the company’s profits under RESPA’s affiliated business arrangement exemption. An
affiliated business arrangement is an arrangement in which a person (such as a real estate broker or agent) is in a position to refer settlement business to a settlement service provider that is owned, in whole or in part, by the referring party. Under this arrangement, the referring party receives no direct payment for the referral to the settlement service provider in which he has an ownership interest, but can receive indirect compensation based on the profits of the affiliated provider. For example, a real estate brokerage firm and a mortgage broker may set up a new company to do mortgage lending without violating RESPA. This arrangement designed to provide “one stop shopping” to consumers would qualify for the exemption only if the company is determined by HUD to be a *bona fide* provider of settlement services rather than a sham arrangement designed to illegally funnel compensation to persons who refer it business. HUD determines whether the arrangement is legal under RESPA by (1) considering ten factors that point to whether the company is a *bona fide* settlement service provider; and (2) examining whether the company owners receive payments only in the form of a return on ownership interest that is not tied to the actual, estimated or anticipated volume of referrals the owners make to the company. The ten factors or questions that HUD asks in evaluating whether the jointly formed company is a *bona fide* settlement provider are:

1. Does the new entity have sufficient initial capital and net worth typical in the industry to conduct the settlement service business for which it was created? Or is it undercapitalized to provide the work it purports to provide?
2. Is the new entity staffed with its own employees to perform the services it provides? Or does the new entity have “loaned” employees of one of the parent providers?

3. Does the new entity manage its own business affairs? Or is an entity that helped create the new entity running the new entity for the parent provider making the referrals?

4. Does the new entity have an office for business which is separate from one of the parent providers? If the new entity is located at the same business address as one of the parent providers, does the new entity pay a general market value rent for the facilities actually furnished?

5. Is the new entity providing substantial services, i.e., the essential functions of the real estate settlement service, for which the entity receives a fee? Does it incur the risks and receive the rewards of any comparable enterprise operating in the marketplace?

6. Does the new entity perform all of the substantial services itself? Or does it contract out part of the work? If so, how much of the work is contracted out?

7. If the new entity contracts out some of its essential functions, does it contract services from an independent third party? Or are the services contracted from a parent, affiliated provider, or an entity that helped create the controlled entity? If the new entity contracts out work to a parent, affiliated provider or an entity that helped create it, does the
new entity provide any functions that are of value to the settlement process?

8. If the new entity contracts out work to another party, is the party performing any contracted services receiving a payment for services or facilities provided that bears a reasonable relationship to the value of the services or goods received? Or, is the contractor providing services or goods at a charge such that the new entity is receiving a thing of value for referring settlement service business to the party performing the service?

9. Is the new entity actively competing in the market place for business? Does the new entity receive or attempt to obtain business from settlement service providers other than one of the settlement service providers that created the new entity? and

10. Is the new entity sending business exclusively to one of the settlement service providers that created it? Or does the new entity refer business to a number of entities, which may include one of the providers that created it?

While HUD has indicated that a joint venture does not necessarily need to comply with all of factors to be RESPA compliant, the less the conformance with the standards the greater the risk of a claim under RESPA. HUD balances the responses to the above questions and no one response is determinative. To qualify for the exemption, the real estate company as the referring party may receive payments only in the form of a return on ownership interest. A return on
ownership interest does not include (1) payments that vary by the amount of actual, estimated or anticipated referrals; or (2) payments based on ownership shares adjusted on the basis of previous referrals. When assessing whether a payment is a return on ownership interest or a payment for referrals of settlement business, HUD will consider, among other things, whether or not:

1. Each owner or participant in the new entity has made an investment of its own capital, as compared to a “loan” from an entity that receives the benefits of referrals;

2. The owners or participants of the new entity received an ownership or participant’s interest based on a fair value contribution; or the interest is based on the expected referrals to be provided by the referring owner or participant to a particular cell or division within the entity;

3. The dividends, partnership distributions, or other payments are made in proportion to the ownership interest (proportional to the investment in the entity as a whole); or the payments vary to reflect the amount of business referred to the new entity or a unit of the new entity; and

4. The ownership interests in the new entity are free from tie-ins to referrals of business; or there have been adjustments to the ownership interests in the new entity based on the amount of business referred.

HUD has expressed concern about settlement service providers who jointly establish a mortgage company, particularly when all the services the new company will provide are subcontracted to the existing parent settlement service providers. For example, a real estate broker and lender might agree to form a
new company, joint venture, limited partnership, or other entity to receive the referrals. As joint owners of the new entity, the real estate broker and the lender would share the benefit of the referrals by receiving their returns on ownership interest in the new entity. HUD will closely review the activities of the new company to ensure it has employees performing valuable or “core” services. If the new company merely subcontracts with someone else, such as the existing mortgage company, to perform most of the essential services, then HUD may view the company as a sham entity created to disguise illegal kickbacks for the referral of settlement services business.

Finally, RESPA requires that a referring company which is in some way financially tied to the company to whom business is being referred provide an Affiliated Business Arrangement Disclosure Statement to the buyer or seller. The disclosure must show the nature of the relationship between the person making the referral and the service provider and an estimated charge or range of charges generally made by the provider. A copy of the disclosure prescribed by HUD is attached to this paper. This disclosure form is required to be given to the consumers at the time that the referral is being made where the referral is made face-to-face, by electronic means, or in writing, and within 3 days if the referral is made by telephone. If the referring company is a real estate brokerage firm, it may be a good practice for the firm to routinely get the disclosure signed by all customers and clients of the firm (i.e. – at the time of a listing with a seller or at the time of contract with a buyer) regardless of whether an actual referral of these customers or clients will be made. The consumer is required to sign the
disclosure in the space provided. If the person chooses not to sign the disclosure, a notation by the referring company must be made stating that the disclosure was provided and the consumer chose not to sign the disclosure at the time it was provided. The notation should be made in a written, electronic, or similar system of records maintained by the referring company in the regular course of business. It is important to tell the consumer that he or she will be required to sign such disclosure at or before closing or settlement even if the person has chosen not to sign the disclosure when it was provided.

The affiliated business disclosure is separate and distinct from the disclosure provided in the new GAR Purchase and Sale Agreement form that states that “Broker may receive a commission, rebate, or direct profit for procuring a mortgage loan, insurance or other services on behalf of the buyer or seller.” This provision is provided to help the REALTOR® comply with rules of the Georgia Real Estate Commission (not RESPA) requiring disclosure when the broker receives certain types of commissions or rebates. This disclosure does not satisfy RESPA requirements, and therefore an affiliated business disclosure prescribed by HUD needs to be provided in addition to this disclosure. REALTORS® also should keep in mind that RESPA prohibits a broker from receiving any “thing of value” for the referral of settlement services regardless of whether or not it is disclosed. Therefore, REALTORS® should not mistakenly conclude that this disclosure or the affiliated business disclosure gives them a license to accept any thing of value for referral of settlement services.
MAY A MORTGAGE COMPANY PAY A FEE TO A REAL ESTATE AGENT FOR ORIGINATING LOAN APPLICATIONS?

Many lenders present real estate agents with alliance opportunities offering real estate salespeople the opportunity to earn revenue associated with the loan application process. One income opportunity is presented when online loan origination systems offer to pay brokers for services rendered, such as giving consumers information about various loan products, pre-qualifying prospective borrowers, and helping borrowers choose a loan product for a particular property by providing information on rates and terms. Brokers may also be asked to collect and transmit information about the borrower and the property, as well as other data necessary for a loan application to be evaluated by one or more lenders. Section 8 of RESPA does not allow lenders to pay for mere referrals, but lenders may compensate real estate agents for services rendered related to loan processing. RESPA allows payment for services actually rendered. Determining where the line is between what is legal or illegal can be tricky and should not be done without the assistance of an expert on RESPA. To be legal, a payment must be for work actually performed and must be reasonably related to the value of the services performed. If the payment is not reasonable, the excess amount is considered payment for a referral and is therefore illegal.

HUD has made clear that the mere taking of a loan application is not sufficient work to justify a fee under RESPA. To determine whether sufficient loan origination work has been performed to justify a fee, HUD looks at the work performed, whether the services are necessary for the loan, and whether the services are duplicative of services performed by others. HUD generally would
be satisfied that no RESPA violation had occurred if a real estate salesperson (1) took information from the borrower and filled out the loan application; (2) performed five or more other loan origination services listed on HUD’s list of application-taking services; and (3) received a fee reasonably related to the market value of the services performed. The more of the listed services a broker provides, the easier it will be to support the reasonableness of any payment received. HUD’s list of “loan origination services” includes:

1. Taking information from borrower and filling out an application;
2. Analyzing borrower’s income and debt and pre-qualifying him or her to determine maximum mortgage he or she can afford;
3. Educating borrower in home buying and financing process, advising him or her about different types of loan products available, demonstrating how closing costs and monthly payments would vary under each product;
4. Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;
5. Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;
6. Initiating/ordering verifications of employment and verifications of deposits;
7. Initiating/ordering requests for mortgage and other loan verifications;
8. Initiating/ordering appraisals;
9. Initiating/ordering inspections or engineering reports;
10. Providing disclosures (truth in lending, good faith estimate, others) to borrower;
11. Assisting borrower in understating clearing credit problems;
12. Maintaining regular contact with borrower, other licensees and lender between application and closing to apprise them of status of application and to gather additional information needed;
13. Ordering legal documents;
14. Determining whether property is located in flood zone (or ordering such service); and
15. Participating in the loan closing.

It goes without saying that a lender that hires real estate agents as “employees” and pays them a fee for each consumer referred to the lender even though the agents perform little or no work for the lender is likely in violation of RESPA. For example, a lender paying up to $100 to real estate agents doing nothing more than filling out and submitting on-line loan application for prospective borrowers would likely be considered a fee for the referral of business in violation of Section 8(a) of RESPA.

CONCLUSION

The above addresses some of the common concerns under RESPA affecting the way real estate professionals do business with mortgage lenders. RESPA is a very technical area of law, and much is left to interpretation. The complexity of the applicable RESPA provisions coupled with the apparently conflicting pronouncements of HUD make it difficult to determine whether
particular arrangements violate RESPA. Situations generally cannot be answered with an unequivocal yes, and the variation of any one factor of the arrangement may impact the analysis under RESPA. Given the great liability associated with RESPA violations and the fact-specific inquiry required to analyze situations under RESPA, REALTORS® are encouraged to consult with their own legal counsel before undertaking any action which could create a risk of a RESPA claim.

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