

HOME BUILDERS WITH AFFILIATED MORTGAGE COMPANIES BEWARE: HUD ISSUES ADVANCE NOTICE OF PROPOSED RULEMAKING ON “REQUIRED USE”

On June 3, 2010, the United States Department of Housing and Urban Development (HUD), which administers the Real Estate Settlement Procedures Act (RESPA), published an Advance Notice of Proposed Rulemaking (ANPR). The ANPR re-visits the RESPA “**required use**” rule as it applies to home builders and their affiliated mortgage companies. According to the ANPR, HUD is exploring rule changes that would target practices of some home builders that allegedly preclude buyers from shopping independently for mortgages or that force buyers into paying more for their homes or mortgages than they should. Rule changes being considered by HUD could prohibit home builders from providing incentives to buyers/borrowers who obtain their home loans through an affiliated or preferred lender.

If this seems like déjà vu, do not be surprised. HUD addressed similar rulemaking just last year, then withdrew it in the face of litigation brought by the home building industry.

The “required use” rule under RESPA currently prohibits any “person” involved in an escrow relating to a federally related mortgage loan from requiring, as a condition to providing access to the person’s service or product, that the borrower pay for another settlement service through a particular provider. Despite objections from the home building industry, “persons” have been interpreted to include home builders, and “settlement service providers” have been considered to include affiliate mortgage companies. If interpreted that way, any home purchase and sale contract that appears to require, as a condition to the sale, that the buyer obtain its loan solely through a specific lender potentially violates RESPA.

In late 2008, HUD proposed a significant expansion of the definition of “required use,” which would, subject to some exceptions, arguably prohibit a home builder from even offering **incentives** or **discounts** to a buyer for obtaining its home loan through the builder’s affiliated or preferred mortgage company. The National Association of Home Builders and others sued HUD to prevent the rule modification, and in May, 2009, HUD withdrew its proposal for a new definition of “required use.”

HUD is determined, nevertheless, to address complaints from home buyers to the effect that they were precluded from shopping for loans. This prevention of competition allegedly allowed affiliated lenders to charge settlement costs or interest rates that were not competitive with those of non-affiliated lenders. The complaints, according to HUD, indicated that some incentivized referrals to affiliated lenders may constitute “steering” techniques that effectively “require the use” of the affiliate. At the same time, HUD states in the ANPR that it “remains committed to preserving the benefits of voluntary contracts that involve true discounts,” suggesting that incentives offered by home builders which provide real a benefit to the buyer, and which are truly optional to the buyer, will not be prohibited. How HUD plans to balance these two interests is unknown. If the final rule approaches the scope of the 2008 proposal, home builders and their affiliated or preferred mortgage companies could find their established business practices to be no longer allowed under RESPA and their ability to offer inducements to buyers for using particular lenders severely restricted.

The ANPR is seeks comment from the general public, including the home building industry, in six categories:

1. The timing of home purchase contracts in relation to the timing of loan commitments, and the nature of incentives offered to homebuyers for using affiliated lenders.

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- 2.The effect of proposed rulemaking on the apparent practice by builder-affiliated mortgage companies of purchasing forward loan commitments.
- 3.Whether discounts built into the price of a home are true discounts or whether they are recouped by the builder by means of a previous mark-up or a charge elsewhere in the transaction.
- 4.The impact of state and local regulations and enforcement on affiliated mortgage practice.
- 5.Whether there is a way to quantify the benefit to home buyers of “one stop shopping” for their purchase and financing.
- 6.The relationship between incentives to use an affiliated settlement service provider and disincentives or penalties for using a nonaffiliated settlement service provider, and how incentives and disincentives might be treated in the new regulation.

Greater detail on HUD’s intentions and its inquiries to the public can be found in the ANPR itself, published in the Federal Register on June 3, 2010, at Volume 75, Number 106. The ANPR can also be viewed on the worldwide web at <http://edocket.access.gpo.gov/2010/pdf/2010-13350.pdf>. We expect that the state and national home building industries will coordinate to provide useful and important feedback to HUD. Cox Castle intends to be at the forefront of that process. The deadline for submission of comments is September 10, 2010.

In the meantime, marketing and sales programs for home builders and affiliated mortgage companies should be reviewed and modified as necessary to anticipate possible new HUD rules and to avoid the types of practices that HUD may view as being deceptive or anti-competitive in the context of RESPA.

For more information regarding HUD’s ANPR, RESPA or sales and marketing regulations for homebuilders, or regarding consumer home sales in general, contact:

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