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Regulations Division
Office of the General Counsel
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
451 Seventh Street, SW Room 10276
Washington, D. C. 20410-001

Re: Comment on Docket No. FR–5180–P–01 titled 'Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs' (the "Proposed Rule") regarding the Department's proposal to revise the definition of "Required Use" in its Regulation X, §3500.2

To the Department of Housing and Urban Development:

Our Houston-based law firm represents financial institutions, mortgage bankers, and mortgage brokers in the process of mortgage loan documentation and closings for thousands of Texas home loan transactions each month. We practice exclusively in the field of residential mortgage banking and real estate law, and our legal services include preparing home mortgage loan documents and counseling our clients in related federal and state regulatory compliance, real estate, title, and closing matters. I am Board Certified in Residential Real Estate Law by the Texas Board of Legal Specialization and have written and lectured extensively on the subject of Texas and federal regulation of housing finance.

The Issue: Does HUD's Proposed Change in the Definition of "Required Use" Better Serve the Purposes of RESPA?

The Department has requested comments on "whether the proposed change in the definition of "required use" will better serve the purposes of RESPA and whether further improvements could be made in the definition to accomplish the intent of the affiliated business exemption in Section 8 and the prohibition in Section 9 on the required use of a title company." The proposed change in the definition of "required use" would effectively repeal the current interpretive rule in effect for the past 16 years that permits homebuilders to offer their homebuyer customers discounts and rebates for the purchase of multiple settlement services (i.e., closing costs) conditioned on the use by the homebuyer of the loan origination services of an affiliate mortgage company and/or the insuring and closing services of an affiliate title insurance company without violating the "no required use" prohibitions of Regulation X, §3500.15, regulating affiliated business arrangements.

Contrary to the Department's assertion that its proposed change in the definition of "required use" would better serve the purposes of RESPA, we conclude from our reading of the Proposed Rule (i) that the proposed revisions to the definition of "required use" would instead frustrate the purposes of

RESPA and thwart the very intent of Congress in first authorizing affiliated business arrangements, from which it was contemplated that consumer benefits in terms of lower costs and better services would stem; (ii) that the proposed revisions to the definition of "required use" are an inappropriate and particularly heavy handed regulatory rulemaking response to what are essentially enforcement concerns expressed by the Department; and (iii) that the Department has neither adequately studied these issues nor developed reliable, objective data upon which to base rational rulemaking, as required by applicable administrative law. A discussion of these issues and our specific recommendations to the Department in this regard follow:

Discussion: HUD's Proposed Revision to the Definition of "Required Use" Would Throw the Baby Out with the Bathwater

The Department proposes to revise the definition of "required use" [Reg. X, §3500.2] specifically to prohibit homebuilders from offering discounts, rebates, and other financial incentives to home buyers conditioned on the use of the homebuilder's affiliated mortgage company and/or title insurance agency (although nominally the prohibition would apply to others in affiliated business arrangements, as well). Homebuilders currently are permitted to offer financial incentives in the form of discounted packages of settlement services to homebuyers conditioned on the use by the homebuyer of an affiliated mortgage company or title company in connection with the purchase of the property so long as the package of settlement services is optional to the homebuyer and the discounts are true discounts below the prices that otherwise are generally available to the consumer and are not recouped elsewhere in the settlement process. Although requiring the use of an affiliate is prohibited under affiliated business arrangement regulations, the definition of "required use" currently has an express "carve out" that permits the offering of discounts or rebates to consumers for the purchase of multiple settlement services without violating the "no required use" prohibitions of §3500.15 regulating affiliated business arrangements:

> "*Required use* means a situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service. <u>However, the offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process</u>." (Emphasis Added)

At the same time, the Department has rightfully considered so-called *disincentives* imposed by homebuilders to be a violation of the "no required use" prohibitions regulating affiliated business arrangements, such as a homebuilder's imposing monetary penalties in the form of additional fees or imposing more onerous contract terms if the homebuyer declines to use an affiliate. However, under the Proposed Rule, the Department would now inexplicably reverse its position of the past 16 years that is based on the simple truism that discounts and rebates that lower settlement costs benefit consumers and thereby further the essential purposes of RESPA. The Department now proposes to interpret these selfsame RESPA provisions to equate positive incentives such as the offer of discounted settlement costs with disincentives, such as the imposition of additional fees or punitive contract terms. This fuzzy thinking would equate a carrot with a stick and reward with punishment. Assuming consumer discounts and rebates in any case are in fact optional and otherwise conform to this definitional test, there is no

rational basis for equating such an apparent consumer benefit with prohibited punitive measures designed to coerce consumers into agreement to use affiliated providers.

Specifically, the Proposed Rule would revise the definition of Required Use in §3500.2 to expressly prohibit conditioning any such offer of discounted settlement services on the borrower's using or failing to use a "referred provider of settlement services," as follows:

> *Required Use* means a situation in which a **borrower's access** ~~a person must use a particular provider of settlement service in order to have access~~ **to some distinct service,** ~~or~~ **property, discount, rebate, or other economic incentive, or the borrower's ability to avoid an economic disincentive or penalty, is contingent upon the borrower using or failing to use a referred provider of settlement services.** ~~and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service.~~ However, the offering **by a settlement service provider** of **an optional combination of *bona fide* settlement services to a borrower at a total price lower than the sum of prices of the individual settlement services** ~~a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services~~ does not constitute a required use. ~~Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.~~

This revised definition would provide that the offering by a "settlement service provider" (a term that would generally exclude a homebuilder, as the seller and party to the transaction) of an optional package or combination of bona fide settlement services to a borrower at a total price lower than the sum of the prices of the individual settlement services would not constitute a "required use." Thus, it would appear under the revised rule that homebuilders could no longer offer such discounts and rebates conditioned on the use of its affiliates, but optional discounts could be offered directly to homebuyers by the homebuilders' affiliated mortgage companies and title companies themselves. However, the Department then suggests in its accompanying Regulatory Impact Analysis (page 3-77) that such offers could not be made by mortgage lenders or other settlement service providers solely to customers of their affiliated homebuilders (or any particular homebuilder). Such a limitation, hidden as it is in the mire of the separate impact analysis document, cannot be gleaned from a "plain language" reading of the Proposed Rule itself and would have the deleterious, and perhaps unintended, effect of prohibiting such practices beneficial to consumers as "close out" marketing (e.g., when special discounts and rebates are offered homebuyers during a promotional period as incentives to sell the models or the last homes offered by a homebuilder in a particular subdivision) and "joint marketing" agreements (e.g., when an unaffiliated mortgage lender is designated a "preferred lender" by a particular homebuilder or condominium developer based in part on its agreement to jointly advertise and promote a particular housing development and provide consumer discounts and on-site loan origination and counseling services to homebuyers.)

Congress recognized the potential consumer benefits of "one-stop shopping" when amending RESPA in 1983 to allow for the creation of affiliated business arrangements. The benefits to a homebuyer who chooses to use the homebuilder's affiliated mortgage company were readily apparent and in practice typically include (i) the *on-site convenience* of receiving immediate credit counseling, pre-approval analysis, and loan origination services (often at the very location of the home site or builder's sales office); (ii) the *efficiencies* of interacting with loan officers who are knowledgeable and experienced in financing of new home sales and who have particular knowledge of the builder's home plans and specifications, the construction stages and process, the process for selection by the homebuyer of colors,

finishes, and building materials during construction, the terms and conditions of the builder's standard sales contract, and the survey and land title issues that are particular to the very subdivision in which the home will be constructed; (iii) *accelerated loan underwriting and approval* if the homebuyer qualifies (and typically the offering of free credit counseling or credit repair services for any applicant who fails to qualify), and (iv) the *pass through to the consumer of cost savings*, principally in the form of allowances, concessions, discounts and rebates offered by the homebuilder. However, the Proposed Rule would undermine Congressional intent in this regard by changing the definition of "required use" to repeal the authority of homebuilders to offer such financing incentives to their homebuyer customers who choose to use the homebuilder's affiliated mortgage company or title company without violating the "no required use" prohibitions of affiliated business arrangement regulations.

Yet, the Department fails to advance any convincing rationale for why such a drastic rule change is needed or desirable. The Department presents no factual data or analytical studies at all in support of its supposition that "disingenuous" (as characterized by the Department) homebuilders have abused the current rule, but instead sets out only a few unsubstantiated, unattributed, unquantifiable, and unreviewable one-sentence anecdotal accounts of consumer complaints received by the Department. These complaints according to the Department were to the effect that, in order to get the benefit of the discounted settlement services offered by the homebuilder, the consumer paid a higher sales price or a higher interest rate or origination fee than the "market rate." Had they been reviewed, simple explanations may have resolved many of these consumer complaints. For example, consumers unfamiliar with "risk-based" pricing may confuse "market rate" with the current rate quotes by mortgage lenders and brokers published in the newspaper each day for the most creditworthy "A paper" applicants and complain that they, with their 650 credit score, did not get the benefit of the "market rate." Furthermore, these anecdotal accounts seem to be contradicted by the only objective evidence considered by the Department in the form of surveys conducted by respected J. D. Powers & Associates, which found that the majority of borrowers surveyed who financed through a builder's affiliate were satisfied with the experience. According to J. D. Powers, borrowers reported that "they chose to borrow from builder affiliates because the interest rates were competitive and . . . the process was easier." Moreover, there is no suggestion that the complaints received by the Department are statistically significant in number or that they allege specific misconduct on the part of the homebuilders or their affiliate mortgage or title companies..

The Department's justification for the rule change instead seems to be centered on the alleged practices of some homebuilders (i) who offer non-monetary incentives conditioned on the use of an affiliate mortgage company, such as an allowance for additional landscaping, countertop granite upgrades, or a "finished patio or basement" that are difficult for the homebuyer to evaluate and compare "apples to apples" against competing offers of other mortgage companies to determine which is the better offer; (ii) who build the discounts into the cost of the homes themselves, so that they are not "true" incentives or discounts (but instead are penalties because they result in supposed higher sales prices); or (iii) who "surreptitiously" increase home prices or other charges above market price to recover the cost of the discounts or rebates offered (a practice that the Department acknowledges would be illegal under the current rule defining "required use" without a rule change).

The Department observes that builders' discounts must be legitimate and not built into the price of the house or the cost of the loan under the current rule, but that "[t]his is nevertheless difficult to monitor and enforce", and, therefore, "prohibiting builder discounts altogether is more effective" (See Regulatory

Impact Analysis, page 3-78). This rationale appears to be little more than the Department's "throwing up its hands" in resignation that it is hard work enforcing RESPA and a rule outlawing builder offers of consumer discounts and rebates altogether would be easier on HUD to monitor and enforce. It would also be easier on the National Association of Mortgage Brokers (NAMB) cited by the Department as the source of industry data apparently relied upon by the Department as authentic, such as the assertion that "affiliated lenders tend to offer interest rates ¼ % to ½ % higher than [the rate] borrowers could get from an independent lender" (Regulatory Impact Analysis, page 3-77). The NAMB, of course, is a special interest group whose member mortgage brokers have long railed against the advantage that affiliated mortgage companies have to capture loan originations of buyers of new homes because their affiliated homebuilders offer packages of consumer discounts and rebates that competing mortgage brokers cannot match. The NAMB's several unsupported assertions cited (and apparently found persuasive) by the Department in its analysis, therefore, can only be viewed as self-serving and not authoritative. The NAMB's frequently cited claims that such builder discounts constitute a prohibited "required use" or illegal "tying arrangement" have been uniformly rejected by the courts, most recently in the instructive case of *Yeatman v. D.R. Horton, Inc*., 2008 U.S. Dist. LEXIS 33446, No. 407CV081 (S.D. Ga. Apr. 23. 2008), dismissing the plaintiff's class-action claim on these issues with prejudice.

It bears clarification by the Department, however, that by stating that the builder's discounts "must not be built into the price of the house," the Department means simply that the price of the house must not be increased in any case to cover and offset the amount of the discounts — an admitted disincentive that would violate the "no required use" prohibitions of the affiliated business arrangement regulations. But it is a specious argument by some to suggest that builder's discounts are not true discounts simply because the source for payment of the discounts or credits is proceeds from the home sale. In one sense, all costs of sale are "built into" the price of the house. For example, a new home offered for sale to the public at $250,000 has a budget for all costs of sale consisting of land, development, construction materials and labor, interest carry on the interim construction loan, marketing and advertising costs, real estate commissions, and administrative and overhead costs. The difference in the sales price and the costs of sale, of course, is profit. Builder discounts offered homebuyers are paid or credited to the homebuyer by the homebuilder at the closing of the home sale and are deducted from the builder's proceeds from the sale, reducing the builder's net proceeds or profit in like amount. The discounts or credits are bona fide, monetary (reducing the homebuyer's closing costs dollar for dollar), and properly disclosed on the HUD-1 Settlement Statement of each transaction. Importantly, the sales price of the house is not increased to cover and offset the amount of the discounts, credits or rebates. The homebuyers, in this example, would pay the same agreed sales price of $250,000 whether they choose to finance the purchase of the house through the affiliated mortgage company or an unaffiliated mortgage company of their own choosing. The homebuyers simply would not be entitled to the incentive package of discounted settlement services offered by the homebuilder if they choose to use another mortgage company. However, since the builder discounts or credits are monetary and certain in amount, the homebuyers may compare the Good Faith Estimates and initial Truth in Lending disclosures issued by the affiliated mortgage company and any competing mortgage companies to determine which on balance offers the better overall rate, terms, and settlement costs. The purposes of RESPA are better served in this example, which typifies practices under the current rule, because the homebuyer benefits from significantly lower settlement costs if choosing to finance the home purchase through the homebuilder's affiliate, but is empowered under the Proposed Rule to shop and compare costs among competing mortgage companies before deciding which offers the more attractive financing costs and terms.

Therefore, if the Department persists in its proposed rulemaking, we urge the Department not to throw the baby out with the bathwater by eliminating this significant consumer benefit through the repeal of the current 16-year old rule that permits homebuilders to offer to wholly pay or discount their customers' settlement services under these conditions. If the Department's true concerns are centered on the difficulty it perceives consumers may have in evaluating offers and the difficulty it may have in enforcing the current rule when homebuilders offer non-monetary allowances and other concessions, such as materials upgrades (which essentially are adjustments to the sales price of a house), then it should address that issue alone in its rulemaking.

The Department in that case should moderate its proposed revision to the definition of "required use" to clarify that (i) homebuilders' offers of discounts in the price of a house, or other adjustments to the price of a house in the form of allowances, concessions, and upgrades, conditioned on the use of affiliates would constitute a "required use," but (ii) offers of discounts in optional packages of settlement services (i.e., closing costs) by homebuilders and other persons in a position to refer settlement service business conditioned on the use of affiliates does not constitute a "required use." To illustrate how that could be accomplished (while preserving as much of the Department's proposed language as possible), the revised definition of "required use" might read as follows:

> ***Required Use*** **means a situation in which a borrower's access to some distinct service or property, or a borrower's access to some price discount, rebate, allowance, or other concession in connection with the purchase and sale of some distinct property, or the borrower's ability to avoid an economic disincentive or penalty, is contingent upon the borrower's using or failing to use a referred provider of settlement services. However, the offering by a settlement service provider or other person who is in a position to refer settlement service business of an optional combination of *bona fide* settlement services to a borrower at a total price lower than the sum of prices of the individual settlement services that is contingent upon the borrower's using a referred provider of settlement services does not constitute a required use.**

Recommendations: Withdraw Proposed Revisions Pending Further Study and Analysis of Objective Data or Modify Proposal to Preserve Homebuilder Conditional Offers of Discounted Settlement Services

As discussed in the preceding section, the Department in the Proposed Rule has offered only conjecture and the barest of anecdotal accounts of consumer complaints to justify changing the 16-year rule that the Department itself promulgated when it adopted the current definition of "Required Use" in 1992 rulemaking. There is no internal analysis or statistical data offered in support of the need or justification for the rule change that could be reviewed and fairly refuted by interested parties as required under applicable "notice and comment" administrative procedures. Instructive in this regard is the recent case of *Ameridream, Inc. v. Alphonso Jackson, Secretary, United States Department of Housing and Urban Development*, Civil Action No. 07-1752 (PLF), in which the United States District Court of Washington, D. C. granted summary judgment to plaintiff Ameridream, Inc. and vacated the Final Rule adopted by HUD on October 1, 2007 (the "DPA Final Rule") that would have disqualified as a permissible source of gift funds any charitable organization or other down payment assistance provider that is reimbursed, directly or indirectly, by the seller of a property, including a homebuilder, or any other person or entity that financially benefits from the transaction. The court based its opinion and order

setting aside the DPA Final Rule on its findings of deficiencies in rulemaking procedures that demonstrated a lack of reasoned decision making required under the federal Administrative Procedures Act. In particular, the court observed that the DPA Final Rule "did not provide [a] loan portfolio analysis [alluded to, but not produced, in the Final Rule], did not provide a meaningful account of its conclusions, and did not contain information about HUD's methodology employed in the analysis," which "deprived [plaintiffs] of any meaningful opportunity to comment on what became the centerpiece of the rationale underlying the Final Rule." (Under the Administrative Procedures Act, the most critical factual material that is used to support an agency's position must be made public in the proceeding and exposed to the possibility of refutation by interested persons.) There are marked similarities in HUD's expressed rationale for promulgating the two rules, including notably, under the DPA Final Rule, HUD's unsubstantiated assertion that the sales price of a home purchased with seller-funded down payment assistance is most often inflated to ensure that the seller's net proceeds are not diminished and, under the Proposed Rule, HUD's unsubstantiated assertion that the cost to the builders of incentives and discounts have been built into the sales price of the homes, so that they are not true discounts. The failure to conduct any analysis of factual data and present the data and analysis as the underlying rationale for the Proposed Rule so that it may be scrutinized and refuted by interested persons in accordance with the requirements of the Administrative Procedures Act would seem a fatal defect in the Proposed Rule on this issue.

We accordingly urge the Department to withdraw from present consideration its proposal set forth in the Proposed Rule to amend the definition of "required use" pending adequate study of the issue, during which the Department may undertake to develop reliable, objective data upon which it may base rational rulemaking consistent with applicable administrative rulemaking requirements. If the Department nevertheless persists in adopting a Final Rule amending the definition of "required use," we would then urge the Department to modify its proposed revisions so as to expressly preserve the authority of homebuilders to offer to pay all or any specified portion of the homebuyer's total settlement costs conditioned on the homebuyer's election to use an affiliated mortgage company or affiliated title insurance company in connection with the transaction without violating the "no required use" prohibitions of affiliated business regulations [Regulation X, §3500.15(b)(2)], generally as discussed on page 6 of this letter.

We appreciate the opportunity to comment on the Department's Proposed Rule and continue to believe that the interpretive guidance provided by the Department through its interpretive rulemaking authority and the "reliance on rule" protections the rules provide our clients making a good faith effort to conform their practices to the rules is of great service to the home mortgage lending industry.

Respectfully,

J. Alton Alsup
For the Firm