

Focus: RESPA

Risk Of Overly Aggressive Marketing In A Slowing Real Estate Market

By Lawrence Jacobson

In today's shrinking real estate marketplace, service providers are all looking for ways to increase their business volume. When "incentives" are involved, or where referrals are being recruited, violations of RESPA can easily occur. Here are some tips for recognizing and avoiding them.

The long anticipated slowing down of the residential real estate market finally appears to have arrived. Fortunately, it appears to be a soft landing rather than a bursting bubble, but nonetheless, a slowing market is an obvious problem for residential real estate providers such as real estate brokers, mortgage brokers, escrow companies, and title

companies, all of which need an ongoing source of business to survive.

Service providers that grew in an ever-expanding market are now under increased pressure to find new business to cover their overhead and profit expectations. With fewer people either selling or buying homes, fewer homes being refinanced, and fewer purchases requiring financing, service providers are under pressure to more aggressively market their services. In doing so they may employ marketing strategies which may expose them to serious violations of federal law or at the least go beyond ethical limits.

RESPA RULES

Since the enactment of the Real Estate Settlement Procedures Act in 1974 it has been illegal in virtually any residential real estate transaction for a service provider to receive any fee, kickback or anything of value as an inducement to or in recognition of the referral of a real estate settlement service. Thus, a real estate broker who offers to pay \$500 to any person who refers a new listing to him violates RESPA. Any mortgage broker who offers to pay \$200 to any real estate broker who refers a prospective borrower to him violates RESPA.

Inasmuch as a violation of RESPA runs the risk of a fine of up to \$10,000 or up to one year in jail per violation it is obviously a significant risk to violate this federal statute. The Department of Housing and Urban Development is

now enforcing the anti-kickback provisions of RESPA more strongly than ever and it is incumbent on real estate settlement service providers to be familiar with the RESPA prohibitions.

A major problem posed by RESPA is that its definitions are so broad and its exemptions are so narrow service providers are quite frequently at a loss to know what they can or cannot do. Unless their regular legal counsel has done work in the area and is familiar with the nuances of RESPA, they run the risk of interpreting exemptions broader than they were intended to be read, finding themselves inadvertently in violation of the statute.

While it is clear that cash is "something of value," what is less clear is that many other things can be considered of value that might not at first blush be thought so by the person providing them. A real estate broker who owns an office building and rents space to a mortgage broker who pays above market rent is receiving a referral fee and both the mortgage broker and the real estate broker have violated RESPA. Conversely, the mortgage broker who leases space to a real estate broker at below market with the expectation of or in response to the referral of prospective borrowers has violated RESPA. Sharing equally the cost of a newspaper ad advertising both the mortgage broker and real estate broker can be a violation if 90 percent of the ad is devoted to the real estate broker and only 10 percent to the mortgage broker.



About the Author

Lawrence H. Jacobson is a lawyer with offices in Beverly Hills, CA. His practice includes business law, real estate transactions, real estate brokerage law, mortgage brokerage law, finance, estate planning, and trademarks. He has testified as an expert witness in numerous cases involving real estate matters. Mr. Jacobson previously served as Vice President of Legal Affairs for the California Association of Realtors and was on the faculty for California Association of Realtors' Graduate Realtors Institute.

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COMMON MISCONCEPTIONS

Service providers seeking to compensate third parties for the referral of business usually look to one of three exemptions to validate the payments. Exempt from the prohibition on referral fee or kickbacks under RESPA are payments “to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.” Also exempt are “normal promotional and educational activities.” And finally, a payment by an employer to its own bona fide employee for generating business for that employer is allowed. Unfortunately, these exemptions are frequently viewed as a way of getting around the referral fee prohibition rather than viewed within the context of the purpose of RESPA. As such, they are quite frequently misunderstood and misapplied, with a resulting violation of the anti-kickback prohibitions of RESPA.

A mortgage broker who encourages

a broker to refer a loan prospect to him may seek to compensate the real estate broker by paying him for performing some nominal service such as filling out a loan application. The Department of Housing and Urban Development which administers the Real Estate Settlement Procedures Act has issued guidelines for when the mortgage broker may pay a fee to a third party for loan origination work without violating RESPA. The guidelines make it clear that the work being done must be significant and the amount of compensation paid must be reasonably related to the value of the services performed.

There is a common misconception among service providers that merely labeling a person an employee and giving them a W-2 or 1099 somehow makes them exempt. For the exemption to be available the person must be an actual employee. If the sole activities of the

“employee” are the occasional referral of a prospective borrower or prospective buyer, the “employee” keeping no office hours or having any other responsibilities or duties, labeling him an “employee” does not make him one in the eyes of HUD.

Real estate brokerage firms that have mortgage banking divisions should also be aware that payments to their real estate salespersons for referral of business to the mortgage banking division are prohibited even if the salespersons are employees as opposed to independent contractors. For purposes of this exemption, a real estate salesperson is deemed never to be an employee, always an independent contractor, notwithstanding how they may be treated for tax purposes.

It should also be noted that there is an exemption for payments between real estate agents. This does not mean that in a state like California, where mortgage



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RESPA FOCUS

brokerage companies can be operated under a real estate broker's license, that a real estate broker functioning as a mortgage broker can pay a referral fee to a real estate broker acting as a real estate agent. The exemption makes it clear that it applies only to fee divisions within real estate brokerage arrangements where all parties are acting in a real estate brokerage capacity and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.

Thus, although residential real estate broker A can refer a prospective client to real estate broker B and receive a referral fee, mortgage broker A cannot refer a prospective borrower to mortgage broker B and receive a referral fee even though both A and B are operating under a real estate broker's license.

UNDERLYING PURPOSE

It is important for service providers to understand the underlying purpose of RESPA. In enacting RESPA, Congress was concerned that the payment of referral fees would influence service providers to refer people to other providers not because they were the best provider of services, but because they offered the best referral fee. Also of concern to Congress was that the cost of the referral fees and other promotions could be passed on to the consumer, increasing the cost of the services to be provided. In analyzing any promotional program, the service provider should consider what the Congressional intent in enacting RESPA was and whether what they are proposing to do by way of business promotion is consistent with the concerns of Congress.

Provided they do not increase the cost

to the consumer and are not "inducements" (or are only incidentally inducements), programs can be developed which are consistent with the requirements of RESPA.

For example, in Southern California it is common practice for the seller of property to pay for the title insurance policy. A real estate broker could offer to pay for the title insurance policy for any person who listed their property with him. This is no different than if the real estate broker reduced his commission rate to induce someone to list their property with him. It would not be a payment of a referral fee, but a reduction in the overall cost to the person for whom the settlement service is being provided.

Thus it not only does not increase the cost to the consumer, it in fact, reduces the cost to the consumer and thus would be perfectly all right. Likewise, a mortgage broker who offered to pay for the cost of an appraisal for any borrower who chose to refinance their property through that mortgage broker would not be violating RESPA. Note, however, that an offer by a mortgage broker to pay a referral fee to a seller of property who referred the buyer to the mortgage broker would be a violation of RESPA because it is not the receiver of the services who is getting the referral fee but the third party who referred it. Payments to third parties other than the one who provided the referral can, under certain circumstances, be appropriate as well. For example, a mortgage broker can advertise that he will make a \$50.00 contribution to the American Cancer Society from his commission on every loan he closes.

Payment of referral fees is a time honored business tradition. We have all received lovely Christmas gift baskets at year-end to thank us for business relationships and the referral of business. Time honored though the traditions may be, if the referral of business relates to the purchase or finance of residential property it makes little or no difference whether it is better to give or to receive. In either event civil and criminal sanctions of RESPA are to be ignored only at the service provider's peril. ■

— Lawrence Jacobson



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