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Referrals to Affiliated Appraisal Management Company Deemed to Fall Outside RESPA AfBA Safe Harbor

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Mortgage lenders should take note of a recent U.S. District Court for the Northern District of Georgia Order and Report and Recommendation finding that a referral arrangement between Amerisave Mortgage Corporation and its affiliated appraisal management company did not qualify for the safe harbor provided in Section 8(c)(4) of the federal Real Estate Settlement Procedures Act for affiliated business arrangements.

A magistrate judge for the U.S. District Court for the Northern District of Georgia issued an Order and Report and Recommendation in which she found that a referral arrangement between Amerisave Mortgage Corporation ("Amerisave") and its affiliated appraisal management company, Nova Appraisal Management Corporation ("Nova"), did not qualify for the safe harbor provided in § 8(c)(4) of the federal Real Estate Settlement Procedures Act ("RESPA") for affiliated business arrangements ("AfBAs").[1] Mortgage lenders should take note.

The Facts

The decision in this case, which was filed as a putative class action, was rendered in the context of a motion for class certification. As such, it is rather skimpy concerning the details of the arrangement between Amerisave and Nova. Nevertheless, it appears that the arrangement was as follows:

- When a consumer applied to Amerisave for a mortgage loan, he/she would receive a RESPA-compliant AfBA disclosure statement setting forth the nature of Amerisave's affiliate relationship with Nova.
- After giving the consumer that disclosure, Amerisave would order an appraisal from Nova.
- Nova in turn would order the appraisal from an independent appraiser, monitor the status of the order to ensure that the appraisal was delivered in a timely fashion, have the appraisal report reviewed by an independent third party and, if the

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report was deemed acceptable, deliver the report to Amerisave.

- The consumer would be charged a $100 appraisal review fee for Nova's services as well as the fee that Nova had to pay the independent appraiser for his/her report.
- The only thing of value that would pass from Nova to Amerisave as part of this arrangement was a return on Amerisave's ownership interest in Nova.

RESPA § 8 and the AfBA Safe Harbor

RESPA § 8(a), with specified exceptions, prohibits a person from giving or receiving a fee or other "thing of value" pursuant to an agreement or understanding that settlement service business will be referred.[2] RESPA defines "settlement services" to specifically include the rendering of appraisals, as well as the rendering of any other services related to the origination, processing or funding of a federally related mortgage loan.[3]

In 1983, Congress enacted a new exception to RESPA § 8 for AfBAs (the "AfBA Safe Harbor"). It did so in response to an informal interpretation from HUD, which at that time had exclusive rulemaking and interpretative jurisdiction over RESPA, that referrals among affiliated settlement service providers may violate RESPA § 8 even when the only thing of value that passes between them is a return on ownership interest.[4]

The AfBA Safe Harbor essentially provides that nothing in RESPA § 8 shall be construed as prohibiting AfBAs so long as: (1) the referring person gives the consumer a compliant AfBA disclosure statement at the time of the referral; (2) the consumer is not required to use the AfBA; and (3) the only thing of value received by the referring person from the AfBA is a return on ownership interest.[5] With specific regard to the second of these three conditions, the AfBA Safe Harbor also provides that "if the referring person is a lender [,it may, notwithstanding the required use prohibition, require] the borrower to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent its interest in the real estate transaction" (the "Required Use Exception").

This case addresses the scope of the Required Use Exception and, specifically, whether it extends to the required use of an appraisal management company.

The Magistrate Judge's Decision

Amerisave asserted that plaintiff's motion for class certification should be denied because all of the class members' claims fall within the AfBA Exception and would therefore fail as a matter of law. The magistrate judge rejected this assertion, finding that while the Amerisave/Nova AfBA clearly satisfied the first and third of the conditions needed to qualify for the AfBA Exception—since Amerisave gave consumers the AfBA disclosure statement at the time of referral and received nothing from Nova other that a return on its ownership interest in Nova—it did not satisfy the second condition, i.e., that the consumer not be required to use Nova.

Amerisave had argued that since the AfBA Exception permits lenders to require the use of an affiliated real estate appraiser, "by extension" it permits lenders to require the use of an affiliated appraisal management company.

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In support of this argument, Amerisave pointed to a provision in the Truth-in-Lending/RESPA Integrated Disclosures Rule ("TRID"),[6] which requires disclosure on the Loan Estimate of fees for "Services You Cannot Shop For," and lists several examples of such fees, including, specifically, "appraisal fees" and "appraisal management company fees."[7] The magistrate judge characterized Amerisave's reasoning on this point as follows:

> [B]ecause the appraisal management company fee is listed as an example of an item for which the consumer cannot shop, it must be that the exemption . . . for situations in which a lender requires the borrower to use a real estate appraiser chosen by the lender to represent the lender's interest in the real estate transaction, should be extended to cover the situation of when a lender requires a borrower to use an appraisal management company selected by the lender.[8]

The magistrate judge observed, however, that the TRID provision relied on by Amerisave includes fees not only for settlement services referenced in the Required Use Exception, i.e., those provided by an attorney, credit reporting agency or real estate appraiser, but also for other services not mentioned in the Required Use Exception (e.g., flood determinations, homeowner's association certifications, private mortgage insurance, title insurance). Moreover, the judge recognized that lenders may require consumers to use specific settlement service providers without implicating RESPA § 8, since "[a] lender's activity requiring the use of certain settlement services only wanders into the territory of violating [RESPA § 8] where there is a fee, kickback, or thing of value in exchange for referring a real estate settlement service to another."[9]

While the magistrate judge's finding that the TRID provision cited by Amerisave has no impact on the scope of the Required Use Exception appears to be correct, her conclusion that Amerisave is therefore not entitled to the AfBA Safe Harbors overlooks several importance considerations. First, the permission granted by the Required Use Exception for a lender to require the use of an affiliated real estate appraiser cannot reasonably be read literally to apply only to individual real estate appraisers. At the very least, it should be interpreted to extend also to real estate appraisal companies, i.e., legal entities (corporations, limited liability companies or partnerships) that employ real estate appraisers who conduct real estate appraisals, even though such companies are not themselves "real estate appraisers" and no doubt employ some individuals who are not real estate appraisers to perform various administrative and clerical tasks associated with the production and delivery of appraisal reports.

Second, appraisal management companies perform some of the functions normally performed by real estate appraisal companies and/or individual real estate appraisers. For example, appraisal management companies typically monitor the status of the appraisal process, review the appraisers' draft reports to ensure that they comply with applicable appraisal standards and deliver the final appraisal reports to the lenders in the form and format they desire.

Third, recently adopted rules to ensure appraiser independence favor the use of appraisal management companies, since such companies serve to insulate lenders from the process of selecting and paying appraisers and reviewing and possibly influencing their valuations.

Finally, and perhaps most importantly, the

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apparent purpose of the Required Use Exception (based on the wording used therein to describe the providers whose use may be required, i.e., providers who are "chosen by the lender to represent the lender's interest in the real estate transaction") is to protect lenders. The exception likely derives from Congress' belief that lenders must be allowed to select these particular providers because they, alone among all of the settlement service providers involved in a real estate settlement transaction, are engaged specifically to represent *the lender's interest* in the transaction.

Such a belief on the part of Congress, moreover, would be perfectly understandable. To illustrate, it would be nonsensical for borrowers to be allowed to select the lender's attorney whose advice regarding potential title and a host of other issues the lender relies on when deciding whether to proceed to closing. Likewise, it would be nonsensical for borrowers to be allowed to select the credit reporting agency that provides the credit report, or the real estate appraiser who provides the appraisal report, when the lender relies on such reports to underwrite the loan and assess and manage its risk. The same holds true for appraisal management companies; i.e., it would be equally nonsensical for borrowers to be allowed to select the appraisal management company that chooses the appraiser, manages the appraisal process and reviews the appraiser's report for consistency with appraisal standards, when the lender relies on that appraisal report in underwriting the loan. Allowing borrowers to choose any of these providers would greatly undermine lenders' underwriting processes, put them at risk of making loans to unqualified borrowers and invite fraud.

NOTES:

[1] *Loughlin v. Amerisave Mortg. Corp.*, No. 1:14-CV-3497-LMM-LTW, 2018 WL 1896409 (N.D. Ga. Feb. 7, 2018), report and recommendation adopted, No. 114CV03497LMMLTW, 2018 WL 1887292 (N.D. Ga. Mar. 19, 2018).

[2] 12 U.S.C. 2607(a). The exceptions in the original Act included payments (1) by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance, (2) by a lender to its duly appointed agent for services actually performed in the making of a loan, (3) to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed, and (4) pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers. 12 U.S.C. 2607(c)(1) to (3).

[3] 12 CFR 1024.2(b).

[4] *See* letter dated May 15, 1980, from Patricia M. Worthy, HUD Deputy Assistant Secretary for Regulatory Functions, published in Barron and Berenson, FEDERAL REGULATION OF REAL ESTATE AND MORTGAGE LENDING, 4TH ed. 1998; *see also*, 45 Fed. Reg. 49360 (July 24, 1980) (indicating HUD's view that a referral to an AfBA may violate RESPA § 8); and 47 Fed. Reg. 21304 (withdrawing that indication).

[5] Pub. L. 98-181, § 461(b) (enacted November 1983), adding subparagraph (4) to 12 U.S.C. 2607(c). *See also*, 12 CFR 1024.15(b).

[6] 12 CFR 1026.19(e), (f), .37. .38.

[7] 12 CFR 1026.37(f)(2) and Comment 37(f)(2)-2.

[8] Slip Op at p. 17.

[9] Slip Op. at p. 18.

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