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the final federal ruling on the

S.A.F.E. ACT

Little finality, in fact more questions and uncertainty as we are just getting started DJ Pendleton | TMHA STAFF

WHILE FLIPPING CHANNELS the other night I cruised by the obligatory Sports Center stop on ESPN and caught the highlights of our Texas Rangers beating the Minnesota Twins 20 - 6. In the routing the Rangers racked up 27 hits.

Don't worry, I'm not trying to start a side gig as a sports writer. Let's face it, I'm way too much of a nerd to be any good at that.

Remembering the score a few days later in the context of the most recent federal developments with our good friend the S.A.F.E. Act, I started to empathize with the Twins. I can relate to what they must have felt around the fifth inning, with the Rangers ahead by 17 runs, knowing they still had to suffer through four more brutal innings.

In the context of the S.A.F.E. Act, we can all relate to that difficult night for the Twins when we hear the phrase, "and the hits just keep on coming."

Granted, this is probably not the most positive note on which to begin this article. Unfortunately, sometimes the truth hurts.

On June 28, 2011 the US Department of Housing and Urban Development (HUD) published the final federal rules on the S.A.F.E. Act, just two months shy of the three year anniversary of when the Act became law in August 2008.

Here, I've attempted to break the final ruling down for you, including a short history of the S.A.F.E. Act and specific details about the rules.

BACKGROUND

- The S.A.F.E. ACT passed into federal law in August 2008 and required every state pass a state version
- The Texas version of the S.A.F.E. Act, HB 10, passed in June 2009 and contained several differences from the federal Act
- On December 15, 2009 HUD published a proposed federal rule. The proposed rule received over 5,000 public comments
- In July 2010 the Dodd-Frank Financial Reform law came into existence, transferring enforcement authority of the S.A.F.E. Act away from HUD and to the newly created Consumer Financial Protection Bureau (CFPB). The date of the authority transfer from HUD to CFPB was eventually set at July 21, 2011.
- In the 2011 Texas Legislative Session, SB 1124 made further changes to the Texas S.A.F.E. Act
- The SB 1124 changes included a specific *de minimus* exception allowing five (5) or less owner-financed home sales (personal and/or real) in a 12 month period
- Because of Dodd-Frank, the final rules published by HUD will be administered and enforced by the CFPB
- On June 28, 2011 HUD finally published final federal administrative rules for the S.A.F.E. Act

TEXAS IMPACT

BEFORE GOING INTO THE details of the final federal rules, it is important to address the impact these rules will have on the current Texas law and administrative rules.

The quick answer is these final rules will have a profound impact on Texas. However, the pertinent question is "When?"

We have been waiting for the federal rules since the federal S.A.F.E. Act passed in August 2008. The final rules, along with the law, establish the minimum standards all states are required to follow. This mandate is based on the federal preemption and oversight provisions in the federal law.

The rules (as outlined in the following pages) go into great specificity on what types of activities trigger the requirement to be licensed as a mortgage loan originator (MLO).

Certain federal provisions align with some of the current Texas law, whereas other provisions could be construed as deviating from the new federal rules.

An issue occurs in the future if the federal regulator, in this case the new Consumer Financial Protection Bureau, deems a state's law not in compliance with the federal minimum standards. The federal rules outline a formalized procedure of notices and public comment before a final federal determination is made. The rules include a provision allowing the CFPB the option to grant a state operating in "good faith" up to 24 months to make the necessary changes.

The CFPB has yet to formally review Texas' current law. According to the federal rules, once the Bureau reviews Texas' law, any federally

forced changes will occur during a particular timeframe - potentially up to two years after the federal review.

Until a federal review and until the Texas law is changed by the Texas Legislature, the state law remains as it has since our version of the S.A.F.E. Act passed in 2009.

There is current uncertainty as to what the federal regulatory agency will demand, but presuming statutory changes are needed the **Texas law cannot be changed until the Texas Legislature meets again in 2013.**

The short version is this: the bullet has fired, but it most likely won't hit us until after the 2013 Texas Legislative Session. However, it must be made clear that unless there are changes at a federal level between now and then, this will hit us in the near future.

WHAT ARE WE LOOKING AT?

AT THIS STAGE TRYING to provide any clarity is difficult. The federal rules fail to provide a “bright line” test as to who needs to have their MLO license. In fact, the logic used in different parts of the rule contradicts itself and the presence of politically motivated determinations permeates the 151-page rules document.

As I previously mentioned, absent any federal law changes, eventually Texas’ law and rules will come into compliance with the federal rule. Our industry will have to adapt and abide by the new rules.

Since we can’t clearly answer the question of “When?” let me further confuse everyone going into the “How?”

How does one comply with what will eventually be the S.A.F.E. Act in Texas? When the change occurs our current, simple “follow the money” law in Texas will be eviscerated.

Currently in Texas law the analysis is simple: if you receive the same amount of money in a financed home sale as you would had you sold the home for cash, you do not have to become licensed as a mortgage loan originator.

When our easy, straight-forward law is eventually killed, we will be forced to adopt the HUD version and its “activities based” analysis. The federal rules choose to break down various activities in a typical sales process and identify what activities trigger the necessity to have a MLO license. As with any attempt to make a list, one can never pinpoint all the possibilities, variations or fill in every gray area. Reluctantly, such uncertainty is our current reality.

In a perfect HUD/CFPB world

The easiest way to be in compliance with the federal S.A.F.E. Act is to have every individual who talks to a customer about buying and financing a home purchase as a licensed MLO.

Unfortunately, this tactic is practically impossible.

When it comes to drawing lines in the sand HUD commonly “punts” on the specifics, choosing to cast us into no-man’s-land with its use of phrases like “additional facts and analysis” would be needed. HUD defers to a case-by-case analysis as to what crosses the nearly invisible line and what doesn’t.

A final uncomfortable word

I want to preemptively address what I know will be your reaction. Most will read this and think of more questions. Few answers and more questions is par for the course. The only thing I offer in response to your inevitable sea of questions is this: welcome. Welcome to the same sinking ship the industry, state regulators, lenders, lawyers and associations are in - the water is deep and the sharks are circling.

This will be a slow, ongoing and developing area of both law and regulation. Choosing to go with a fact-specific, case-by-case approach means we won’t have certainty until there are enough guinea pig instances that define through litigation and regulation the full spectrum of this area of the law. This will take time over many years, and what I suspect will be some unwilling volunteers stepping out and trying various approaches.

The prayer at the end of the day as we collectively stare up the large mountain we have to climb is the hope we are guinea pigs and not canaries in a coal mine.

...and the hits just keep on coming...

Review: HUD Final Rules on S.A.F.E. Act

PART ONE: CLARIFICATIONS

In the final rules HUD specifically identifies what it refers to as “Key Clarifications.” Many who read the “clarifications” will conclude that rather than clarifying, HUD managed to muddy the water even further. Regardless, below is a summary of the “clarifications.”

1. The first addresses who must be licensed as a MLO under the final rules. HUD focuses on those “engaged in the business of loan origination.” HUD interprets a person is only “engaged in the business” if the individual is operating in a “commercial context” with “some degree of habitualness or repetition.” In essence, HUD created a two-prong test by which, if both conditions are met, the individual must be licensed.
 - First, what does “commercial context” mean? HUD states an individual who originates loans for “the purpose of obtaining profit” is engaged in a “commercial context.”
 - By this reasoning HUD has essentially created new exceptions from licensing for 1) government employees who, as part of their job, help acquire financing for home buyers, 2) non-profits, 3) charities and 4) individuals selling their own home. HUD identifies these activities as not engaging in a “commercial context.”
 - In “clarifying” this key definition HUD created, by rule, previously nonexistent, new exceptions to the S.A.F.E. Act.
 - HUD added to the previous statutory list of exceptions for real estate brokers, attorneys and time shares the four new exceptions above.
 - In a confusing turn of contradictory logic, and not but two pages further in the rules, after declaring these new exceptions, HUD states, “HUD lacks the statutory authority to grant exemptions to licensing under the S.A.F.E. Act.”
 - Sure seems like government employees and non-profits (Habitat for Humanity and other similar housing non-profits) got traded from the Twins just in time.
 - The second element of “engaged in the business” requires a “degree of habitualness or repetition.” However, HUD is not clear on exactly what constitutes “habitualness or repetition.” HUD does not say a specific number of sales nor further define either “habitual” or “repetition.” Interpretations vary a wide degree on this new ambiguity.
 - Some focus on repetition and think any amount over a single transaction is repetitive and therefore triggers this element.
 - Others feel HUD was trying to address the much-discussed issue of a de minimus licensing exception.
 - HUD states later in the final rule an individual would not trigger licensing requirements if they act as a loan originator “only once or very rarely.” Legally unable to declare such a de minimus exception, HUD creates this ambiguity thereby providing an opportunity to argue low volume sellers would not need to be licensed.
 - This, of course, begs the question, “how many is too many?” The answer is no one knows. This is a further “clarification” by HUD that creates uncertainty and confusion rather than any sort of clarity.
2. TMHA worked during Texas’ 2011 Session to pass SB 1124, which did provide a bright line. The Texas law now (even if temporarily) contains a specific de minimus exception for owner-finance personal property sellers. The law allows a person to owner-finance five (5) or less home sales in a 12-month period. However, with HUD specifically stating in their final rule they do not have the statutory authority to grant a de minimus, Texas’ recent law change could be eliminated in the future.
 - Again, with no clear amount of home sales defined, but with the ambiguous ill-defined HUD term of “habitualness,” we find ourselves on this issue like so many other issues - with unclear “clarifications.”
3. In other “clarifications” listed by HUD, the issue of individuals engaged in loan modifications was not clarified. On this issue HUD excluded loan modification language from the final rule, thus such activity would not trigger licensing, but the issue defers to the CFPB.
 - At a later date, the CFPB could bring this issue back up and, possibly, require individuals who engage in material loan modifications to become licensed mortgage loan originators.

PART TWO: DISCUSSION OF PUBLIC COMMENT

Following the “clarifications” HUD addresses some public comments previously received on the proposed rule. The S.A.F.E. Act impacts a wide array of industries and individuals, which is reflected in the comments. I will only discuss the HUD responses impacting the manufactured housing industry.

- Once the analysis of whether or not a person is engaged in a commercial context (i.e. for profit) and does so habitually is complete, the next step in the analysis for licensing is: what exactly is “the business of loan origination?”
 - For this step you have to look at a two-prong test contingent on three key defining phrases. The key phrases/definitions relate to “taking a residential mortgage loan application,” “offer or negotiate terms [of a] loan,” and “for compensation or gains.”
 - The licensing trigger is a two part test. The first is “taking the application.” The second is “offers or negotiates terms of a...loan for compensation or gain.”
 - “[Taking] a residential mortgage loan application” is broadly construed by HUD. “[Taking] an application,” is any request from a borrower for an offer of a loan or in response to a solicitation of an offer and any information from the borrower that is used/needed in order for a lender to make a loan offer.
 - However, HUD specifically states an individual whose only role is physically handling a completed application form or transmitting a completed form to a lender on behalf of a prospective borrow (without reviewing the form themselves) is excluded from the definition of “takes a residential mortgage loan application,” and therefore excluded from needing a MLO license.
 - This addresses some concerns on having to be licensed for merely physically touching an application. HUD states these individuals do not need to be licensed.
- Similar to the first prong of the licensing test, with the second prong HUD casts a wide net in their definitions of “offer or negotiate” and “for compensation or gains.”
 - HUD broadly interprets “offers or negotiates” to include any interaction with the individual and a borrower with respect to a prospective loan where the “individual is likely to seek to further his or her own interest or those of a third party.” HUD goes on to state an individual satisfies the “offer or negotiate” element if the individual presents “particular” loan terms to a borrower for the borrower’s “consideration” for the purpose of a reaching a “mutual understanding” about prospective loan terms.
 - Basically, when you start talking specific terms to a buyer in the hopes of eventually reaching a final agreement, the individual has triggered the licensing requirement.
 - The rules also state it doesn’t matter if a person does not have the authority to change or alter any of the terms or rates, nor does it matter if a final agreement is never achieved. Neither of these situations is enough to fall outside of the broad scope of “offers or negotiates.”
- What is not included and therefore activities that do not trigger the licensing requirement are things like:
 - (a) the mere sharing of general information about a financing source;
 - (c) discussing hypothetical financing options, i.e., options not related to a specific financing source;
 - (e) giving the homebuyer a list of available financing sources without recommending any of the sources;
 - (f) discussing a buyer’s ability to afford a home;
 - (h) presenting or discussing generic facts or generic rate sheets;
 - (i) closing personal property transactions.”
- Similar to HUD’s broad interpretation of “offer or negotiate,” they broadly interpret “compensation or gain.” HUD specifically dismisses the notion “compensation” should only be triggered regarding a sales commission if the commission is contingent on a specific transaction.
 - HUD further addresses the situation of a retailer receiving a sales commission as falling under their broad interpretation of “compensation or gain.” Only an individual who acts “purely as a volunteer” and does not expect to receive “anything of value” is excluded from the broad definition of “compensation,” and therefore does not need to be licensed.
- HUD addresses the action of forwarding an application to a lender or lenders. HUD does not definitively declare whether the activities of a retailer forwarding an application to a limited number of lenders would require licensing.
 - HUD “punts” on this issue and says the analysis of needing a MLO license would be determined based on the specific facts.
 - HUD states if the range of prospective lenders to whom an individual forwarded a borrower’s application was “shaped by, or in accordance with” receiving some financial incentive from someone other than the borrower, then the individual would have to be licensed.
 - On the contrary if an individual forwarded the application to “all prospective lenders known to the individual...that is not skewed” based on the incentive to receive compensation, licensing would not be triggered.
- In the literal language of the final rule HUD does state an individual must be licensed if he/she, “recommends, refers or steers a borrower or prospective borrower to a particular lender or set of residential mortgage loan terms, in accordance with a duty to or incentive from any person other than the borrower or prospective borrower.”
- Clear as mud?

PART THREE: UN-“CLARIFIED” PROVISIONS

ADVERTISING?

- The federal rule has another licensing trigger which they do not elaborate on in any of the commentary or examples. In addition to the test previously discussed on taking an application and offering or negotiating a loan for compensation and gain, a person is required to be licensed if they represent to the public through advertising that the individual can or will perform the activities of taking an application and offering loan terms.
- The lack of further development of this provision by HUD leaves tremendous uncertainty as to what types of advertising fall into this category and require licensing.
- For example, advertisements like “Financing Available,” “We Help Finance,” specific interest rate offers, or estimated monthly payments like “For only \$___ month” tied to a specific home offer.
 - It is uncertain whether these and other similar advertisements would trigger licensing.
- Additionally, the range of what HUD specifically includes as advertising is “advertising or other means of communicating or providing information.” The broad interpretation trend continues and HUD even provides a non-exhaustive list that would fall into this category of “business cards, stationery, brochures, signs, rate lists, or other promotional items.”
- The specific inclusion of a “rate list” again highlights the many internally conflicting positions HUD takes within the rules.
 - In another area of the rules discussing what does not constitute “offering or negotiating” HUD indicates it is permissible to not have a MLO license and provide a borrower a generic fact or rate sheet.
 - And yet “rate lists” is then specifically included under the advertising provision of the rule indicating a MLO license is necessary to provide such information.
 - So, when is it permissible to provide a rate sheet and not be a licensed MLO?
 - The best guess is if it is a “generic” rate sheet; however, “generic is not defined.
- The exposure is there for regulators to make the argument the types of advertising and signage discussed above triggers the licensing requirement. If so, the test on whether a person should be licensed becomes much simpler than having to interview parties to a transaction to see exactly who said what to whom. Rather, the trigger for licensing, and if not licensed then the self-incriminating evidence, could be as simple as a banner or sign outside a dealership.

PULLING CREDIT?

1. Another unresolved area of the rule significant to many current business practices in our industry relates to pulling a consumer's credit report.
2. Many retailers will pull a consumer's credit report early in the buying process simply to help facilitate narrowing down practical buying options. This information is also used by retailers who have experience with various lenders to know which lenders might be interested in financing a loan for a consumer based on their credit report.
3. Currently, a retailer who pulls credit reports must abide by the Fair Credit Reporting Act. However, the new federal rule on S.A.F.E. Act leaves uncertainty as to if the act of pulling a consumer's credit report triggers MLO licensing.
4. Some take the position simply pulling someone's credit does not cross the line necessary to require a license. The argument is merely pulling a credit report doesn't constitute "taking an application" nor does it cross the line of "offering or negotiating."
 - This interpretation relies on the specific exclusion HUD lists as not "offering or negotiating" when an individual "[discusses] a buyer's

5. It can also be argued pulling credit falls under the exception from licensing for "administrative or clerical tasks."
 - HUD defines "administrative or clerical tasks" as, the "receipt, collection, and distribution of information common for the processing or underwriting of a loan in the mortgage industry and communication with a consumer to obtain information necessary for the processing or underwriting or a residential mortgage loan."
 - The argument is pulling a credit report is simply collecting information common and necessary in loan underwriting.
6. The actual exception in the rule states an individual does not need to be licensed if, "an individual who performs only purely administrative or clerical tasks on behalf of a loan originator."
 - The second part of the exception is what some point to as not applying to the situation where a retailer is pulling a credit report because they aren't doing it specifically "on behalf of a loan originator."
 - Additionally, since many lenders will pull their own credit reports rather than use one provided by a retailer, in this scenario the retailer pulling credit initially is not connected to the actual process of underwriting the loan, and therefore fails to fall within the definition of "administrative and clerical."

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COMPENSATION RELATED TO HOME SALE OR LOAN?

1. As we previously discussed, the HUD definition of "compensation or gain" is incredibly broad. The term includes "anything of value."
2. HUD goes on to further dismiss the notion such things like sales commissions or normal salaries are not compensation. HUD also dismisses the notation compensation only occurs if it is contingent on a completed loan transaction.
3. HUD disagreed with such positions on these and other attempts to narrow the scope of compensation, rather steadfastly remaining with their broad interpretation.
 - HUD referenced the current Texas law directly in the rule, further dismissing our current standard if the compensation is the same in a financed transaction as it would have been in a cash transaction, then no license is required. HUD obviously disagrees with this narrower take.
4. HUD does concede there must be some "nexus" between receiving the compensation and the act of "offering or negotiating." However, HUD does not elaborate much further on this idea of "nexus."
5. HUD states clearly that someone acting as a pure volunteer does not receive compensation and therefore doesn't need to be licensed.
 - They also address a salesperson who receives a sales commission on a home sale, but was never involved with the "offering or negotiating" would not have to be a licensed MLO.

- 6. The unresolved issues of compensation hinge on this idea of “nexus” or a required connection between offering terms and receiving anything of value.
- 7. While it is unclear, as so much of the rules are, it seems by HUD’s comments the triggering effect of receiving compensation should relate or connect with the act of generating a loan (thus the offer and

negotiate).

- If this is the case, then compensation as it relates to selling the house itself and not the loan might not trigger licensing.
- 8. More work and attention must be given to this compensation “nexus” idea for us to fully know what types of compensation to whom and for what activities will or will not trigger licensing requirements.

PART FOUR: THE END Which of course means this is just the beginning...

For those still with me I thank you for sticking it out in this hair-pulling exercise of trying to decipher the undecipherable.

Everyone thought it couldn’t get any worse back in what we now know were “the good old days” when we just had the federal and Texas S.A.F.E. Act to navigate. The recent HUD final rule has spun us off into an entire new abyss of never ending questions.

While it can be argued Congress never meant to impact the indirect lending business model of a typical manufactured home retail business in 2008, the fact is, intentionally or unintentionally, they roped us in for the long haul.

Unless things change at a federal level on this law and/or rules between now and when the Texas Legislature gavels back into session in 2013, **eventually all the issues and changes I describe above will be forcibly integrated into our Texas S.A.F.E. Act.**

I wish I could end this article on an upbeat note. I wish there was some bright light of hope

I could turn to so we can all sleep well at night. Unfortunately, I can’t. At least the Twins players knew walking into the locker-room after being pummeled that the next day brought new life and a fresh start. We don’t have this luxury.

When the day comes that the Texas law is changed to match the federal rules, the business model in Texas will change. The absolute, excuse the pun, SAFEst way to comply is to have every person who sells a home that is financed to a consumer become a licensed MLO.

Obviously, this will be impossible in the real world. This leaves us somewhere in the middle to slug it out with regulators and litigators for years to come.

I anticipate a business where salespersons and retailers are forced to walk the delicate line of not saying, doing or directing a consumer in a particular manner and when the time comes to talk specifics of the consumer acquiring a loan, a third-party, MLO-licensed intermediary (either in-house or a contracted independent

MLO) must take over and provide the gateway between borrower and lender. Even this model significantly exposes the industry’s chin to any disgruntled buyer from accusing and testifying that the non-licensed retailer or salesperson did in fact tell them what their rate would be, what their monthly payment would be, or any other particulars of their eventual loan.

These changes will also generate increased costs, fees and insurance rates. All of these will be passed on to consumers still able to afford the now less-affordable affordable housing.

As with all new laws and regulations, the industry must and will eventually adapt. But for a moment I will align with the frustration of many and wish for once, just maybe, common sense solutions could prevail to allow us to sell to our customers the reality of home ownership.

Like I said, we can wish ... but for now we better stop daydreaming in right field, because we are losing by 17 in the fifth inning and Josh Hamilton is digging in the batter’s box. ★

PART FIVE: WHAT TO DO RIGHT NOW Wait until the 2013 Texas Legislative Session & follow the Texas law

- We won’t see any changes to the state’s S.A.F.E. Act until the Texas Legislature convenes for their next session in January 2013
- Until then, follow the Texas version of the S.A.F.E. Act
- The de minimus exception TMHA helped pass in the 2011 Session still applies:
 - The Texas S.A.F.E. Act allows you to sell five (5) or less owner-financed homes in a 12-month period WITHOUT a MLO license
 - The de minimus exception DOES NOT apply to state licenses (Retailer, RBI, etc.) - you must be licensed with TDHCA to sell more than one (1) home in a 12-month period.
- We will not know anything about the federal, regulatory agency’s position on the Texas law until at least 2013

want to speak to

TDHCA’S JOE GARCIA

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