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ROOM FOR RENT....Anyone?

How to Value an Office Sublease for RESPA Compliance



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Agenda

- Why Sublease Space and Services from other Providers?
- Legal Considerations when Leasing from a Referral Source
- Determining “General Market Value”
- Key Don’ts and Do’s
- Importance of properly Valuing Amenities and Services
- Summary of Best Practices in Establishing an Office Sublease
- Q & A



Why Sublease Space from Others?



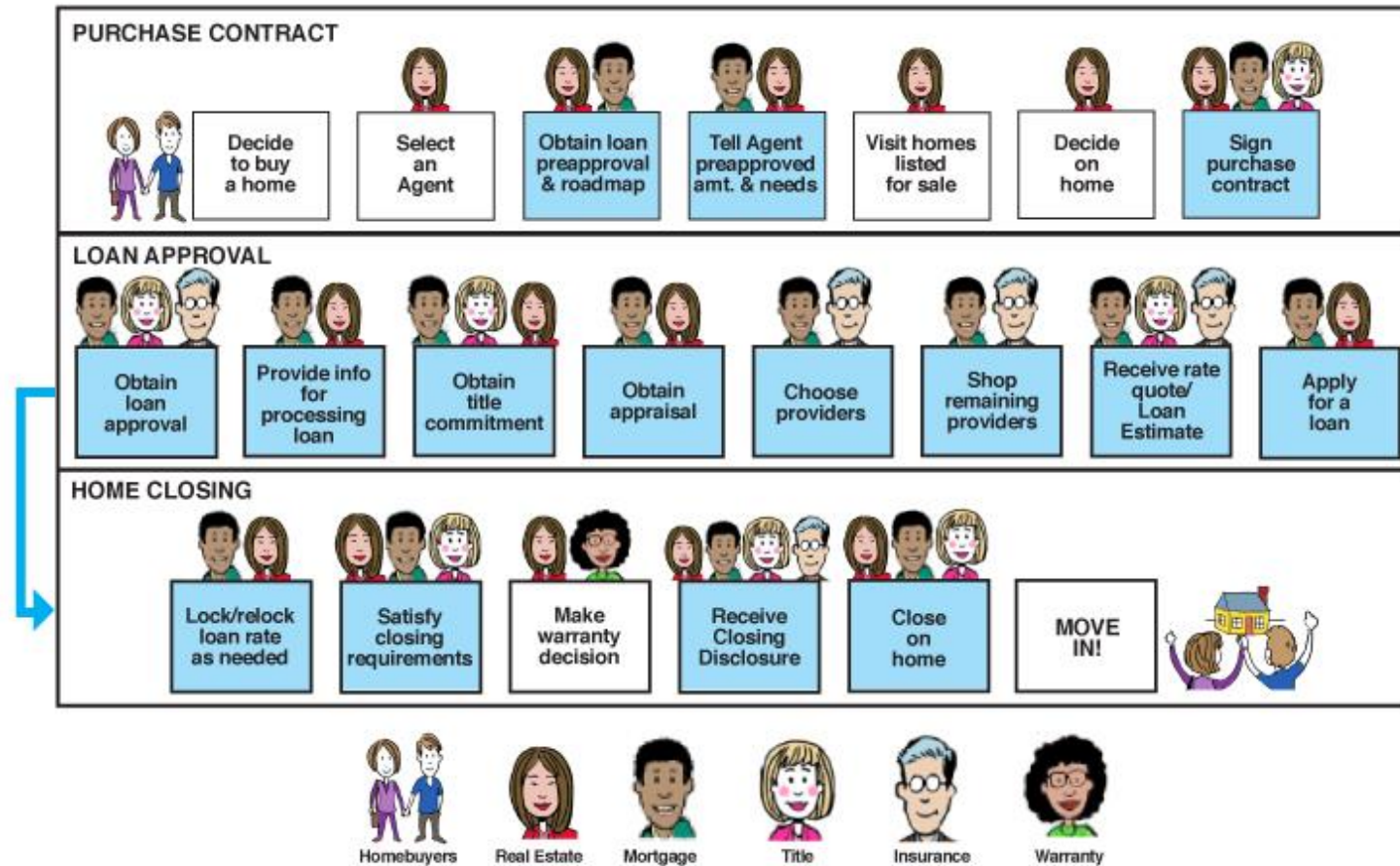
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Why Sublease Space?

- Purchase business is a critical channel for the industry.
- Settlement service providers must be located to reach and serve homebuyers and other key parties to a transaction.
- Accessibility and convenience can lead to collaboration.
- Collaboration can deliver better processes and experience for the consumer
- A better home buying experience is the key differentiator for branding, competing for and winning purchase business.

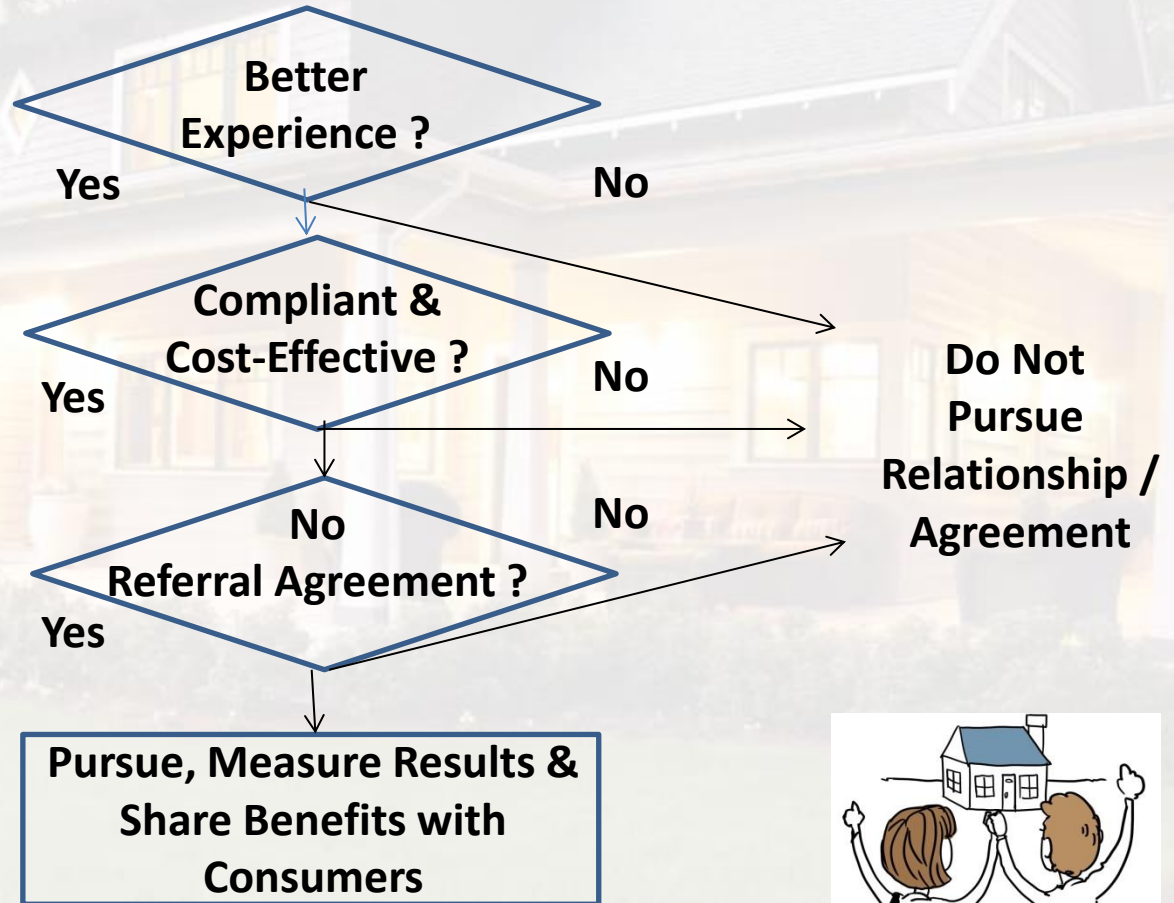


A Better Home Buying Experience



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Key Strategic Relationship Decisions



Legal Considerations when Leasing Space from a Referrer of Settlement Services



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Applicability of PHH Decision to You

- Back to the future
 - 8(c)(2) says:
“Nothing in this section [Section 8] shall be construed as prohibiting...(2) the payment to any person of a bona fide salary or compensation or other goods or facilities actually furnished or for services actually performed.” 12 USC § 2607(c)(2)



Applicability of PHH Decision *(Continued)*

- Back to the future *(Continued)*
 - June 2015: Director Cordray said:
 - ✓ 8(c)(2) not an exemption at all
 - ✓ Mitigating circumstance
 - ✓ Bona fide compensation means “solely for the service actually being provided on its own merits”
 - ✓ Bona fide payments do not include payments tied to the referral of business
 - October 2016 Circuit Court 3-Judge Panel said:
 - ✓ Statutory question in this case “not a close call”
 - ✓ Nothing means nothing
 - ✓ Bona fide payments means “reasonable market value”
 - ✓ Even if parties to transaction engage in referrals
 - ✓ Adopts HUD interpretation of statute



Applicability of PHH Decision *(Continued)*

- Back to the future *(Continued)*
 - January 2018 En Banc Circuit Court said:
 - ✓ “The panel opinion, insofar as it is related to the interpretation of RESPA... is accordingly reinstated as the decision of the three-judge panel on those questions.”
 - Why is This a Big Deal?
 - ✓ Because all office/desk rentals rely upon Section 8 (c)(2) as legal basis for the arrangement
 - ✓ As do:
 - MSAs
 - Lead generation
 - Co-Advertising
 - Internet advertising



The Law

- Court endorses HUD established 2-part test for Section 8(c)(2) Compliance
 - Part 1: Services and Goods
 - ✓ Actual = real
 - ✓ Necessary = useful, meaningful
 - ✓ Distinct = not done elsewhere in transaction
 - Part 2: Reasonable Market Value
 - ✓ Payment commensurate with value of services and goods
 - ✓ Amount in excess of FMV, considered a referral in violation of Section 8(a)
- *** Fact that parties to the arrangement refer business to each other does not prevent compliance with Section 8(c)(2) Safe Harbor Test**



The Law (Continued)

- HUD Statement of Policy 1996-3
 - Since office rentals rely upon 8(c)(2) for legal support, CFPB will analyze whether rent is
 - ✓ Bona fide
 - ✓ Disguised referral fee
 - If payment bears no relationship to market value, excess is not for services or goods, but rather kickback
 - ✓ Violation of 8(a)
 - If rent is calculated on a multiple of the number or value of referrals made
 - ✓ Violation of 8(a)



The Law (Continued)

- HUD Statement of Policy 1996-3 (Continued)
 - If rent paid on a “per use basis” and use derived from referrals
 - ✓ Violation of 8(a)
 - ✓ Example: use of a conference room
 - Value of the referral may not be taken into account in determining General Market Value
 - General Market Value is what
 - ✓ Non-settlement service provider would pay for same space and services in a comparable building



The Law (Continued)

- CFPB Consent Orders

- Fidelity Mortgage Corporation

- ✓ How not to do an office rental
- ✓ Rent based upon the number of referrals made to FMC each month
- ✓ Fined \$54,000 (twice rent paid by FMC)

- Prospect Mortgage Corporation's Desk Rentals

- ✓ Steering expectations part of the deal
- ✓ Exclusivity
- ✓ Rent based upon agent capture rate
- ✓ Rent fluctuated monthly



Leasing from a Referral Source

- Office Lease / Desk Rental Considerations
 - Pay Fair Market Rent
 - ✓ Third party valuation
 - ✓ Consider square footage
 - ✓ Consider ancillary services
 - ✓ Need comparables
 - Make sure written agreement
 - ✓ Describe space, term, rental rate and default remedies
 - Avoid lockouts
 - Do not adjust rent based upon capture rate
 - May need to license location and do protect personal info
 - Ensure space is actually utilized



Determining “General Market Value”



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Accounting for all the Services

- From analysis on thousands of MLinc ComplyOffice™ historical valuations:
 - ~50% of the average general market value is Amenities (conference room use, kitchen access, receptionist/answering services, copy/fax/printer/scanner use, etc.)
 - ~20% of the average general market value is Facilities (furniture/furnishings, common area, janitorial, etc.)
 - ~30% of the average general market value is Base Rent and Utilities.



General Market Value

- Include comparables outside the residential settlement services industry.
- Value space, amenities and other related services.
- Use most current, relevant data available.
- DO NOT value potential referrals.
- Commercial Appraisers may not understand RESPA.



Don't Depend on the Referral Source

- Don't let the lessor dictate a price.
- Don't just pay what the broker's agents are paying (training, license management, MLS fees, technology may be included).
- Don't let the lessor provide comparables, especially if they own the building or have a commercial listing business (avoid appearance of a conflict of interest).



Other Don'ts

- Don't let your loan officer use a friend. Remember, commercial real estate friends may not understand RESPA or the definition of “general market value”.
- Don't rely on quotes from “co-working” vendors (e.g., WeWork, etc.) as those offerings often include social, networking and collaborative community services not reflective of a typical office sublease or desk rental.



Other Don'ts (*Continued*)

- Don't just utilize basic commercial space market quotes (often don't consider additional services like conference room, receptionist, kitchen, etc.).
- Don't depend on general market commentary, which is unscientific and may be based solely on opinion or hearsay.
- Don't rely on valuations that do not consider the bid/ask spread on commercial space and impact on actual lease terms in the market.



Do's in Valuing the Lease

- Do use a valuation methodology that accounts for all the services provided.
- Do utilize RELEVANT submarket comparables or appraisals that consider lease term, building class, and space configuration.
- Do use comparables that are currently available in the submarket (closed transactions may be more difficult to locate, not reflective of current supply and demand, not indicative of tenant allowances, etc.).



Do's in Valuing the Lease *(Continued)*

- Do employ a consistent, compliant approach to valuing all office subleases or desk rentals.
- Do consider obtaining an independent third-party valuation.



Issue(s)?

- “We had a local appraiser look at the space, and he said it was worth more because consumers are walking through the bank lobby right by our desk.”
Not general market value.
- “We just have our loan officer or branch manager contact the closest Regus office for a quote to determine what we’ll pay.”
Not consistent. No check / balance.
- “We know office space on this side of I-95 is going for \$35 per square foot. We don’t need any other information.”
Hearsay. Not considerate of specific space configuration.
- “The broker told me the space is worth \$900 per month, and he should know. I don’t want to argue with him about it; I just want to close loans.”
Not general market value.



Summary of Best Practices

- Be able to describe why you are subleasing.
- Use the arrangement to create a better home buying process and experience to differentiate, brand and compete.
- Make it a real office.
- Use a RESPA-compliant Agreement that involves payment for real services, not referrals.
- Obtain an independent valuation of both space and amenities.
- Verify services as the basis for payment.



Q & A



This presentation is for informational purposes and should not be relied upon as general or particularized legal advice. The unique facts or circumstances of any strategic relationships or agreement between settlement service providers or others should be discussed with legal counsel to determine its compliance with all applicable laws.

