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HUD Examining Captive Lines for RESPA Compliance

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By Brad Finkelstein

A pair of experts in the warehouse lending business believes that captive lines of credit do contain real risk to both the provider and the loan originator. The issue of risk is one of the key points the Department of Housing and Urban Development is looking at, a recently issued notice from the agency stated.

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That is because HUD is re-examining if warehouse lending is a legitimate secondary market transaction as defined by the Real Estate Settlement Procedures Act. This is the first time since the agency issued RESPA rules in 1992 and 1994 that it is examining this question, a notice from the agency said.

Among the issues to be considered, said Phillip Schulman, an attorney with K&L Gates, is what constitutes a bona fide warehouse line. This question comes about with the types of first lines of credit being granted to newly minted mortgage bankers who have moved up from mortgage brokers.

Many of these originators have lines where the warehouse lender is underwriting loans and requiring the loan to be sold to it at or soon after closing. Schulman said such actions start to sound very similar to table funding.

Staking out the position on the pro-secondary market transaction side of the equation are Mary Kladde, president and chief executive, and Ruth Lee, executive vice president of Titan Lenders Corp., Denver.

Both said that even in a captive situation, there is no guarantee that the warehouse/correspondent lender will buy the loan off of the line. The originator is responsible for making it a salable loan, and thus in a captive line situation, it should still qualify as a bona fide secondary market transaction.

The difference between the traditional warehouse line given to larger lenders and captive lines generally is one of the originator's net worth, Kladde said.

"The onus is really on that correspondent, because now they are paying per diem interest on a warehouse line, which, if it was a true table funded arrangement, if there were any delays in purchase associated with clearing post-closing conditions, that is on the investor," Lee added. "They are applying for a commercial line of credit and they do go through the entire due diligence process. They are on the hook as a 'regular' correspondent," because even if the warehouse lender/purchaser underwrote the file, they still have the option not to purchase the loan.

The warehouse transaction is separate from the correspondent loan sale transaction, Lee said. They both noted that if it was a true table funding situation, the originator would not be subject to per diem interest payments.

Furthermore, the captive lines have "some pretty substantial negative arbitrage, because they are not giving them the most desirable terms on that warehouse line of credit," Lee continued.

If the loan is not purchased off the captive line, that originator is still responsible for finding another purchaser to take it off the hook and for servicing the loan until that happens.

Kladde said depending on what might come out of HUD, it could impact those programs that require a certain volume to be sold back to the warehouse investor. But it could also allow for some smaller and more varied players into the warehouse line business, she added.

The captive lines are "lines with training wheels," Lee said. But if loan quality is important in what HUD is looking at, these lines do that. And while the originator "can't fall off and break a leg, they can fall off and bruise the heck out of themselves."

They don't have as much risk and they don't hedge the lines like those originators which have traditional warehouse lines do, but the right for the investor to force repurchase of the loan is still there, she continued. Titan deals with originators all the time to educate them to the fact that because they have a warehouse line, they cannot operate the same way they did as a mortgage broker. The company tries to educate these originators to the fact that they are on the hook.

HUD is asking for comments from warehouse lenders, retail lenders, mortgage bankers, wholesale lenders, correspondent lenders, mortgage brokers and others in the mortgage lending industry. The comment period ends 30 days after the notice is published in the Federal Register.

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