

Expand Your Net

Net branching can be a lucrative way for brokers to increase their bottom line

By **Anthony F. Geraci**, managing partner, Geraci Law Firm

NATIONAL NET BRANCHING CAN be a great profit-maker for mortgage brokers. By partnering with already-established brokerages or lenders, you can obtain and build a national presence for relatively little capital investment. Further, because you will be largely protected from the liabilities your partners incur, there is relatively low risk in entering such arrangements.

Brokers often have a number of questions when hearing about net branching, from what exactly it is, to what the benefits are and how it works. Here are a few common questions — and their answers.

What is it?

Net branching is a popular business arrangement between two brokers or between a broker and a lender. Although it's one of the easiest concepts to understand, it's probably the hardest to define.

Two common definitions are:

1. A business arrangement wherein one mortgage broker associates with another mortgage broker who ultimately brokers a loan to the lender, in exchange for splitting points on the loan; and
2. An arrangement between a mortgage broker and a lender in which the broker can lend money in states where the broker is not originally licensed; in this case, the broker also receives a split in the lender's points on the loan.

Brokers and lenders generally partake in net-branching arrangements using one of two scenarios.

The first occurs when mortgage brokers licensed in one state find deals in another state. In this case, they can either tell the borrowers to go to the other state and not get paid, or they can associate with a broker licensed in the other

state and receive a portion of the points through a net-branching arrangement.

With the latter choice, brokers in each state typically agree to a net-branching arrangement. Assuming both states' licensing laws allow this arrangement to occur, the brokers can work together successfully and both earn a portion of the points.

The second scenario occurs when mortgage brokers wish to develop a national presence but don't have the capital to do so. They can slowly obtain the capital to expand throughout the country, or if they're willing to give up some of their profits, they can partner with an established national mortgage broker or lender. This can help them become a national mortgage company or mortgage brokerage in two to five years.

How does it work?

If the company, licensing and everything else is set up legally, net branching can be an exceptional profit center to add to your existing mortgage brokerage.

Typically, when a national net-branching company forms, it creates divisions for its partners. Divisions are advantageous because the company and other divisions inside the company are protected from that partner's profits and losses, including judgments and other liabilities. Because the division is still a part of the company, this type of arrangement should comply with U.S. Department of Housing and Urban Development (HUD) requirements.

Your attorney must craft partner agreements carefully to create a successful net-branching arrangement. Further, there are other legal requirements with which you'll have to comply. Consult your attorney to determine how to construct such an arrangement.

Is Net Branching Legal?

Whether net branching is legal depends on who licenses you and how the arrangement is structured.

In May 2000, the U.S. Department of Housing and Urban Development (HUD) issued a letter prohibiting what it considered to be "net branching." It defined this as occurring when "HUD/[Federal Housing Administration]-approved mortgagees are engaged in the practice of taking on an existing, separate mortgage company or broker as a branch and allowing that separate entity to originate insured mortgages under the approved mortgagee's HUD Mortgagee Number."

Indeed, in that letter, HUD pointed out that "the distinction between an acceptable and unacceptable alternative branch compensation plan is not whether the manager's or any other employee's compensation is related to the profits generated by the branch. Rather, it is whether the operating expenses are paid by the HUD/FHA approved mortgagee."

In addition, a few states, including Georgia, have stated that their licensees were not allowed to net branch. These states largely seem to follow HUD's criticisms of net branches.

Still, if a net-branching arrangement is constructed correctly, it should comply with HUD's May 2000 letter.



National net-branching arrangements can be profitable for mortgage brokers and lenders. Mortgage brokers wishing to create a national presence may not have the capital necessary. Or brokers who wish to become lenders may only have enough capital to start in one state.

Continued ...



Anthony F. Geraci is the founder and managing partner of Geraci Law Firm in Irvine, Calif. He advises mortgage brokers and lenders on federal and state lending and licensing laws; designs mortgage pools/funds and construction/commercial-loan documentation and defends against lawsuits. Geraci is the real estate finance attorney at the Pitbull Mortgage School and will speak at Pitbull's quarterly seminar on Sept. 27 in Las Vegas. Reach him at (949) 260-9156 or anthony@geracilawfirm.com.

REPRINTED FROM *SCOTSMAN GUIDE RESIDENTIAL EDITION* AND SCOTSMANGUIDE.COM, SEPTEMBER 2007

All rights reserved. Third-party reproduction for redistribution is prohibited without contractual consent from Scotsman Publishing Inc.

Expand Your Net

... Continued

In both scenarios, with a national net-branching arrangement the mortgage broker will give up a fraction of the profits in order to become a national brokering or lending company.

With the market reductions in the past year and with some of the largest nonprime mortgage lenders either declaring bankruptcy or closing their doors, brokers may turn to net branching as a way to stay alive and to capture more of the market share.

Note: This article was written for educational and informational purposes only. Consult an attorney to determine whether national net branching is legal and appropriate to your specific situation. 