In the News

Builders Received Kickbacks, Say Regulators

Homeowners refunded $24 million in settlement with title insurer

Without admitting any wrongdoing, First American Title Insurance Co. of Santa Ana, Calif., agreed in February to refund $24 million to homeowners in Colorado, Arizona, California, and other states in response to allegations that the company had in essence paid 16 large production-home builders to steer business its way. When the Colorado Division of Insurance opened the investigation of First American in October 2004, the company took the concerns seriously enough to stop its practice of forming captive reinsurance arrangements that gave builders a financial incentive to refer clients to First American.

Here's how the scheme allegedly worked: Home buyers paid premiums to First American or one of its subsidiaries, which had been recommended by the builder. The insurance company in turn gave a portion of the premium to a captive reinsurance entity, in exchange for sharing the risk. The problem for regulators was that the middleman — the captive reinsurance company — was owned at least in part by the builder, meaning that money was moving from the title-insurance company to the builder. While it isn't illegal for a builder to make a referral, it is illegal for an insurance company to pay for it.

Another suspicious aspect, according to Erin Toll, deputy commissioner of compliance for the Colorado Division of Insurance, was that title insurance carries very little risk to begin with and normally doesn't need to be reinsured. In fact, in the May issue of *Builder* magazine, Toll was reported as saying, "It's been eight years since the

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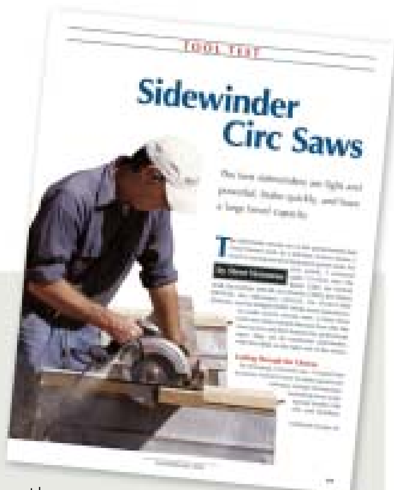
Is a drainage ditch a wetland? NAHB doesn't think so, and wants Congress to use language in upcoming legislation that makes this clear. Other items on the association's May 26 "Wetlands Wish List" include limiting the wetland-permitting process to 120 days or less, and streamlining the Nationwide Permit program.

Defective Blade Guard Prompts Recall

A circular saw that *JLC* reviewed in November 2004 ("Sidewinder Circ Saws") was included in a May 18 recall by Robert Bosch Tool Corp. and the U.S. Consumer Product Safety Commission. Some 69,000 saws sold from February 2004 through April 2005 are affected by the notice, which revealed that the company has received a report of amputation caused by a malfunctioning lower blade guard.

Owners of Bosch saw models CS10, CS20, and CS20-XC should check the product nameplate on top of the motor housing. If there is no asterisk in the serial-number box, consumers are advised to stop using the saw and contact Robert Bosch Tool Corp. at 800/856-9683 or www.boschtools.com for a repair kit. An asterisk after the serial number indicates the problem was corrected by Bosch preshipment and the saw has a properly functioning guard. — *Laurie Elden*



Kickbacks
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conception of these arrangements and not a single claim payment has been made." Also, according to regulators, since the reinsurance company was being paid more than was reasonable for the risk involved, the payments appeared to be compensation for the referral, rather than for reinsurance. In other words, it looked like a kickback.

First American is not the only title insurance company under the microscope. Fidelity National Title of Jacksonville, Fla., and LandAmerica Financial Group of Richmond, Va., have both ceased to use captive reinsurance arrangements in response to regulator concern. All three companies maintain, however, that the business arrangements were legal.

Colorado's investigation started a small avalanche, as other states around the country, including Arizona, California, and Washington, launched their own inquiries. According to an April 7 article in the *Insurance Journal,* regulators such as California insurance commissioner John Garamendi are also considering whether title insurance companies are charging consumers too much. Said Garamendi, "Ceding 50 percent of their premiums indicates there's a whole lot of fat in the game." — *Laurie Elden*

FDIC Study Sheds New Light on Boom Markets

In case you haven't noticed, there's a nationwide boom going on in the housing market. For years, pundits have worried and argued about whether the boom presages an inevitable bust, with home values dropping, equity disappearing, and work for builders evaporating.

A recent report by economists at the Federal Deposit Insurance Corporation (FDIC), the agency that guarantees bank-account deposits, reaches some interesting conclusions about that controversy, based on a look back at the history of local real estate booms and busts. (The full report is online at www.fdic.gov/bank/analytical/fyi/2005/050205fyi.html.)

For one thing, observe study authors Cynthia Angell and Norman Williams, boom times are not always followed by busts — it has actually been more common for a boom to end with a whimper as "a period of price stagnation that allowed local economic fundamentals to catch up with high home prices." Defining "boom" in a metro area market as a three-year price rise of 30 percent or more, and "bust" as a 15 percent price drop over three years, "boom was found to lead to bust in only 17 percent of cases prior to 1998," says the report.

Where busts do occur, the study shows, they are usually traceable to some non-real estate collapse in the local economy — such as occurred in oil towns like Midland, Texas, when oil prices plummeted during the mid-1980s. And busts may happen where there has not been any boom, too; in fact, says the report, "While 21 housing busts have occurred since 1978 under this definition, only nine of them occurred on the heels of a housing boom."

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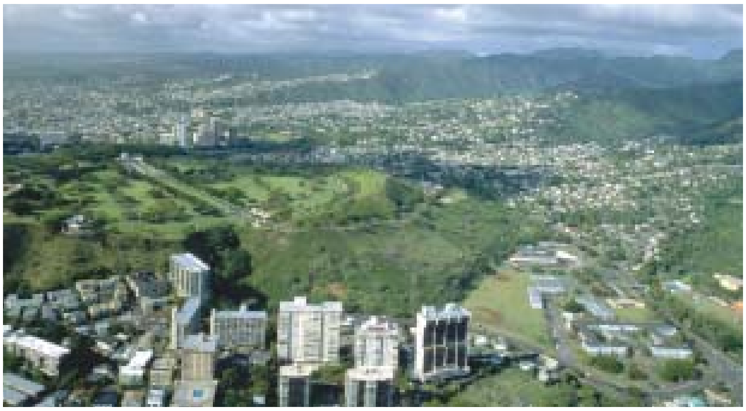

Historically, local housing booms are more likely to end with a whimper than with an all-out bust, says a new report. Still, the authors note some troubling developments that could dampen the national market's current euphoria.

FDIC Study
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But the authors do note several troubling developments. For one thing, the number of boom markets has risen sharply in the last year, from 33 at the end of 2003 to 55 at the end of 2004. Nationally, home prices rose 11 percent in 2004, compared with 7 percent each year in 2003 and 2002. The spreading use of easy mortgages involving no down payment or low initial interest rates could be driving demand, note the authors, and they warn, "To the extent that credit conditions are in fact driving home price trends, a reversal in mortgage market conditions could contribute to an end of the housing boom."

What does all this mean for builders looking to their own business future? Professor C.F. Sirmans, director of the University of Connecticut's Center for Real Estate and Urban Economic Studies, says that in local as well as national terms, it's the underlying need for housing that counts most.

"My advice to builders would be to always remember the fundamentals: Housing demand is driven by income growth and household formation," Sirmans says. "Certainly builders might be concerned if the supply of new houses is increasing too rapidly to match these factors." — *Ted Cushman*

CO Incident Leads to New Legislation

No criminal charges will be filed following an investigation into a deadly carbon monoxide leak on the University of Vermont campus in Burlington, Vt. (see *In the News,* 4/05). According to forensic engineers and state inspectors, the heating system of the privately owned apartment building where the leak occurred had a number of preventable defects that contributed to the January 30 incident, which left one person dead and six others injured, but they declined to find anyone at fault.

Photos: *Burlington Free Press*

Investigators say the Burlington, Vt., gas leak occurred when a boiler misfired and caused an elbow joint (top) in the Plexvent pipe to separate, allowing exhaust gases to escape. A dislodged support bracket (bottom) may have contributed to the incident as well.

The investigation focused on the heating system's 9-foot-long Plexvent plastic vent pipe, which was subject to a 1998 CPSC voluntary recall. The accident happened when the building's Trianco Heatmaker gas boiler misfired, causing an elbow joint in the Plexvent pipe to separate and leak exhaust gases containing high levels of CO into the rest of the building. Investigators agree that the misfire was caused by a "maladjusted" gas valve in the boiler, which had been serviced only hours before the incident.

In addition to the gas valve and defective pipe, chief investigator John Certuse, director of engineering for Industrial Services & Engineering of Attleboro Falls, Mass., found several code violations and design flaws in the heating system. For example, the boiler room lacked sufficient ventilation to supply both the boiler and the gas water heater with adequate combustion air, which can cause delayed ignition and increased exhaust-gas CO levels. Investigators also found that the 3-inch-diameter Plexvent pipe wasn't pitched adequately and had a misplaced and partially blocked condensate drain, allowing water to drain back into the boiler and cause misfiring and corrosion. And Certuse speculated that a dislodged support bracket discovered during his investigation might have allowed the vent pipe to move excessively during a boiler misfire, contributing to the detached pipe elbow.

Sadly, the incident could have been avoided. Records show that on at least three occasions, New England Air Systems, the company servicing the building's boiler, notified the building's management that the flue pipe needed replacement. But because the service invoices didn't refer to either the recall notice or the safety issues involved, no action was taken. Finally, the building had no CO detectors to alert residents of the leak. Prompted by the incident, Vermont has since joined a handful of other states that require carbon monoxide detectors in all new residences and apartment buildings. — *Andrew Wormer*