

LAND CONTRACTS: DEAD OR ALIVE?

On January 10, 2014, new federal regulations went into effect which impact sales on land contracts in Michigan. Since that time, based on the number of calls to the Legal Hotline, it would appear that many REALTORS® have been struggling to sort out the many rumors which spring up weekly about the continued viability of sales on land contract and how the new regulations impact the way REALTORS® do business. Unfortunately, there are no easy answers. In order to gain a complete understanding of the impact on seller financing, it would be necessary to penetrate several layers of regulation. These include the requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (“SAFE Act”), the Michigan Mortgage Loan Originator Licensing Act (“MLOLA”), the Michigan Mortgage Brokers, Lenders, and Servicers Licensing Act, the Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (“TILA”) and more. That being said, there are some basic points upon which REALTORS® can rely and which should hopefully simplify the situation a bit.

How Do the New Regulations Directly Impact REALTORS® in Dealing with Seller Refinancing?

The answer to this question is simple. The new regulations do not directly impact REALTORS® in conducting regulated real estate license activities. In other words, if a REALTOR® takes a listing from a seller who is intent on selling his property on land contract, the REALTOR® can take the listing, market the property and procure a buyer/vendee the same as he would if he was listing property that did not involve seller financing.

Many REALTORS® have expressed concerns about their liability to sellers who sold properties on land contract after January 10, 2014, and who were unaware and thus, presumably

did not comply with the new regulations. Fortunately, there is nothing in the new regulations which require real estate licensees to make certain that their sellers comply with the new seller financing regulations. Assuming the REALTOR® did not attempt to act as a lawyer in these transactions and simply performed his or her duties as a real estate licensee, the REALTOR® should have no liability.

Going forward, however, REALTORS® dealing with sellers who intend to sell on land contract are well-advised to consider using the new Form Q, “Seller Financing Addendum to Exclusive Listing Contract (Residential Property)”. This form is designed to put sellers on notice that if they do engage in seller financing, there are a number of new regulations that may apply and that they should seek legal advice and/or financial advice from persons fully versed in the new regulations.

Do the New Regulations Apply to All Land Contracts?

The new regulations only apply to seller financing involving a “residential mortgage loan.” A “residential mortgage loan” is defined as a loan primarily for personal, family or household use that is secured by a lien on a dwelling. A “dwelling” is defined as a residential structure or mobile home which contains 1-4 family housing units or individual units of a condominium or cooperative.

The new regulations do not apply to seller financing in the following situations:

1. The sale of vacant land not intended for construction of a residence;
2. The sale of multi-family property (*i.e.*, in excess of 4 residential units), commercial, industrial and any other property which a buyer does not intend to use for “personal, family or household use”); and

3. The sale by a seller on land contract of a residential property which is the only sale on land contract by that seller during a 12-month period.

There is another situation involving the sale of a residential property on land contract which may also be exempt from the new regulations. As noted above, the SAFE Act, MLOLA and the applicable portions of TILA apply only to loans which are “primarily for personal, family or household use.” Questions have arisen as to whether the new regulations would apply to the sale of a residence (1-4 units) when the buyer does not intend to live in the residence, but is purchasing the residence for use as a rental property. There is no case law interpreting the new regulations as of yet because they only became effective as of January 10, 2014. However, there has been significant case law interpreting what is meant by “primarily for personal, family or household use” in other contexts. For example, under the federal Consumer Credit Protection Act, it has been determined that the “profit motive seems to be the decisive factor” in determining whether credit is offered to a consumer “primarily for personal, family or household use.” If the consumer is seeking the loan to generate a profit, the loan would not be for “personal, family or household use.” Further, in construing this same language as used in RESPA, courts have determined that a loan to acquire a non-owner occupied rental property is a business purpose loan not covered by RESPA. In sum, a strong, good faith case can be made that sellers need not comply with the new regulations when they are selling to a buyer on land contract whose intent is not to occupy the property, but instead to rent it to a third party. Any seller involved in such a transaction would be well advised to consult with a lawyer or financial expert regarding the appropriate methods of documenting the buyer’s intent at the time of closing.

What About the Three Land Contract Sales Exclusions?

There is considerable confusion among REALTORS® as to the three “exemptions” available to sellers on land contract under the SAFE Act Final Rule/MLOLA and the same “exemptions” under the federal TILA.

With respect to the exemptions under MLOLA and the SAFE Act’s Final Rule, REALTORS® should consult the Michigan Department of Insurance and Financial Services’ “Mortgage Loan Originator and Seller Financing FAQs.” It is provided in the FAQs:

. . . Unless other evidence to the contrary indicates that an individual is “engaged in the business” of loan origination, during a 12-month period from January 1 to December 31, an individual will not be considered to be engaged in the business of mortgage loan origination if the individual is not engaged in any activity under the MLOLA except seller financing transactions AND the individual originates three or fewer . . . mortgage loan transactions.

In other words, unless a seller is otherwise engaged in the business of loan origination, a seller can sell three or fewer properties during a 12-month period without compliance with MLOLA or the SAFE Act Final Rule.

Like MLOLA and the SAFE Act Final Rule, there is also a 3-property “exclusion” or “exemption” under the federal TILA. This exclusion is not only available to natural persons, but can also be used by other organizations, such as corporations and limited liability companies. However, it is important to note that unlike under MLOLA and the SAFE Act, under the TILA 3-property exclusion, there are a number of limitations on the terms of the land contract. First, the seller cannot be a builder who has constructed a residence on the property in the ordinary course of business. Second, the financing terms of the land contract must be fully amortizing. There can be no negative amortization or balloon payments in the land contract. Third, the seller

has to determine in good faith that the buyer “has a reasonable ability to prepay.” Finally, the interest rate on the land contract must either be fixed or adjustable only after five or more years.

Under TILA, if a seller sells only one property on land contract in a 12-month period and does not construct the residence on the property in the ordinary course of business (*i.e.*, is not a builder), then the land contract can have a balloon payment and a variable rate of interest (as long as it is in compliance with Michigan usury laws). This broader 1-property exemption under TILA is only available to natural persons, trusts and estates. It cannot be used by organizations such as corporations or limited liability companies.

The purpose of this article is twofold. First, to let REALTORS® know when the new regulations do not apply. Second, to let REALTORS® know that when the new regulations do apply or there is a question as to whether a sale is exempt or excluded from the application of the new regulations, sellers should be directed to a lawyer or financial advisor knowledgeable in these matters. REALTORS® should consider using “Form Q” or other similar form for this purpose.