Seller Financing
Impact of the Safe Act and the Dodd-Frank Act

(July 5, 2011)

EXECUTIVE SUMMARY

Seller financing plays an important role in financing the sale of real estate, especially when credit is tight. This paper summarizes the impact of two federal laws that affect seller financing. On July 30, 2008, President George W. Bush signed into law the Secure and Fair Enforcement for Mortgage Licensing Act (the SAFE Act). The SAFE Act requires licensing or registration of loan originators. On July 21, 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or DFA). The Dodd-Frank Act restructures the oversight of financial regulation and includes amendments to the Truth in Lending Act (TILA). Both of these laws will affect seller financing, except to the extent exempted.

SAFE Act. Licensing of loan originators under state laws enacted pursuant to the SAFE Act and meeting minimum federal requirements is already required. The HUD website has information about the SAFE Act. HUD has published a final rule establishing minimum federal standards that requires licensing of individuals who engage in the business of a loan originator. An individual engages in the business of a loan originator if the individual, in a commercial context and habitually or repeatedly, takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain. HUD's overall responsibility for interpretation, implementation, and compliance transfers to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011. The law exempts those who only perform real estate brokerage activities unless compensated by a lender, mortgage broker, or other loan originator (or their agent). Unless brokers/agents engage in the business of a loan originator, they will not have to be licensed as loan originators.

Dodd-Frank Act. Title XIV of the DFA states that no creditor may make a mortgage loan without making a reasonable or good faith determination that the customer has the ability to repay the loan. "Qualified mortgages," as defined in Title XIV, are considered to have met the ability to repay standard. The Federal Reserve Board published a proposed rule on May 11, 2011. Comments are due to the CFPB by July 22. The CFPB takes over responsibility for Title XIV on July 21. Title XIV will not take effect until final regulations to be issued by the CFPB go into effect. CFPB has until January 21, 2013, to issue the final regulations, and they must take effect no later than 12 months after their issuance. If CFPB misses the deadline, Title XIV takes effect anyway on January 21, 2013.

The DFA definition of mortgage originator exempts an individual (or an estate or trust) that provides mortgage financing for no more than 3 properties in any 12 month period from the requirements of Title XIV, but only if the financing meets certain rules:

1. The seller did not construct the home.
2. The loan is fully amortizing (no balloon mortgages allowed).
3. The seller determines in good faith and documents that the buyer has a reasonable ability to repay the loan.
4. The loan has a fixed rate or is adjustable after 5 or more years, subject to reasonable annual and lifetime caps.
5. The loan meets other criteria set by the Federal Reserve Board.

DETAILED SUMMARY

SAFE ACT

As described by HUD, the SAFE Act was promulgated to "…to enhance consumer protection and reduce fraud by directing states to adopt minimum uniform standards for the licensing and registration of residential mortgage loan originators and to participate in a nationwide mortgage licensing system and registry database of residential mortgage loan originators."

The SAFE Act requires states to establish loan originator licensing requirements that meet minimum requirements with respect to residential mortgage loans made primarily for personal, family or household use. Loan originators who are employees of banks are subject to less onerous registration requirements. To give states an extremely strong incentive to participate, the SAFE Act gives HUD authority to establish a back-up licensing system for any states whose requirements do not meet minimum SAFE Act requirements or do not participate in the Nationwide Mortgage Licensing System and Registry (NMLSR). All states have enacted legislation requiring licensing through NMLSR administered by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR).

The SAFE Act does not explicitly exempt individuals who choose to finance the sale of residential property they own (often referred to as seller financing), but HUD's final rule only requires licensing for individuals selling their own property, or other property, if they are engaged in the business of a residential mortgage loan originator. The final rule clarifies that an individual engages in the business of a loan originator if the individual, in a commercial context and habitually or repeatedly:

(1)(i) Takes a residential mortgage loan application; and (ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain; or

(2) Represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such individual can or will perform the activities described in (1).

The law exempts those who only perform real estate brokerage activities unless compensated by a lender, mortgage broker, or other loan originator (or their agent) and they engage in the business of a loan originator.

SAFE Act Exemptions

Though HUD states that it lacks statutory authority to grant exemptions to licensing under the SAFE Act, it does make a distinction between individuals who meet the definition of "loan originator" versus those individuals who "engage in the business" of a loan originator. Of particular interest to real estate professionals are the following examples.

- HUD advises that, "absent evidence to the contrary, the sale and financing the sale of one's own residence, vacation home or property, or inherited property" is not likely to be considered to be engaging in the business of a loan originator.

- Brokers/agents rarely, if ever, take an application or offer to negotiate terms of a residential mortgage loan for REO transactions and typically would not have to be licensed as loan originators in these transactions.
- To trigger the licensing requirements under the SAFE Act, the financing must be primarily for personal, family, or household use. This means that real estate owners selling property to someone who intends to use the property as a rental investment property are exempt, and investors selling non-residential property with seller financing are also exempt.
- Land sold for development is excluded from the kinds of seller financing affected by the SAFE Act. The Act requires licensing with respect to the sale of land only if the loan is primarily for personal, family, or household use and only if there is intent to construct a residence on the land. However, if someone buys a lot with the intent to build and occupy a home on the property and the seller provides seller financing, SAFE Act licensing would be required.
- If the financing is for business purposes, SAFE Act licensing requirements do not apply.
- A seller financing the sale of his or her own property completely avoids the issue of licensing by retaining the services of a licensed loan originator and having that individual carry out the function that constitute engaging in the business of a loan originator.

Here are several examples of who is not exempt:

- Individuals (including real estate professionals) are not exempt if they engage in the business of a loan originator because they provide financing habitually and repeatedly. HUD chose not to decide how frequently an individual may provide financing before reaching the requisite degree of habitualness. NAR thinks that the CFPB will likely defer to reasonable state law on the number of seller financing transactions that would require licensing, and NAR will continue to monitor any further guidance.
- Individuals who provide financing for a property they do not own are only required to be licensed if they engage in the business of loan origination.

In other words, anyone who wants to provide financing for a residential property to a buyer who will use the property for personal, family or household uses is required to be licensed under the SAFE Act only if they engage in the business of a loan originator.

Activity at the State Level

The SAFE Act required each state to develop and promulgate its own law that meets the minimum requirements of the federal SAFE Act, no later than July 31, 2010. All states have now enacted their own loan originator licensing laws. Everyone potentially affected by the SAFE Act should check out their state requirements which may have higher requirements than the federal law.

While the SAFE Act imposes new requirements on the licensing and registration of loan originators, states have interpreted the applicability to seller financing differently. A few states have enacted no exemption for seller financing—even for the sale of the seller's own residence. Others states explicitly exempt seller financing from licensing requirements. Some exempt seller financing if they finance fewer than a certain number of sales within a specified period. At least one state reportedly believes that seller financing is an installment sale not subject to the SAFE Act at all, but HUD has specifically stated that is incorrect. HUD chose not to decide how frequently an individuals may provide financing before reaching the requisite degree of habitualness. NAR will continue to monitor any additional guidance, but expects CFPB to defer to reasonable state laws on the number of seller financing transactions that would trigger licensing.

DODD-FRANK ACT (DFA)

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NOTE: The DFA exemption for seller financing of no more than 3 properties in any12 month period does not apply to the SAFE Act loan originator licensing requirements.

NAR sought a total exemption, but was unsuccessful. As a fall-back, NAR sought an exemption for sellers financing the sale of up to 5 properties in any 12 month period, but that was also rejected. Congress was only willing to grant a narrow exemption for sellers providing certain types of seller financing for no more than 3 properties in any 12 month period.