

“ARE LAND CONTRACTS NOW SAFE UNDER THE SAFE ACT?”

Regulators Suggest Land Contracts Are Not Subject to New Law

Background

In 2008, Congress passed and President George Bush signed into law the Housing and Economic Recovery Act, (Public Law 110-289) (HERA). HERA is designed to assist with the recovery and the revitalization of America’s residential housing market – from modernization of the Federal Housing Administration, to foreclosure prevention, to enhancing consumer protections. **The SAFE Act** is a key component of HERA.

The SAFE Act is designed to enhance consumer protection and reduce fraud by encouraging states to establish minimum standards for the licensing and registration of state-licensed mortgage loan originators. The SAFE Act requires states to have licensing and registration systems by July 31, 2010. Indiana’s SAFE Act law was passed last year and goes into effect in June 2010. An easier-to-read version of the Indiana law appears in the Indiana Administrative Code.

You Need a License, If You Are a “Loan Originator”

You need a loan originator’s license, if you are a loan originator as defined by the new Indiana law enforcing the SAFE Act. In a sentence, anyone who offers or provides a residential mortgage loan or extends credit for a home purchase is deemed a loan originator and is required to get a license.

You Might Be a “Loan Originator”

The SAFE Act defines “loan originator” as “an individual who (1) takes a residential mortgage loan application; and (2) offers or negotiates terms of a residential mortgage loan for compensation or gain.” This definition is broadly interpreted. If you sell a residential property on credit, YOU ARE PROBABLY A LOAN ORIGINATOR under the SAFE Act.

Indiana’s Law Has (Already) Changed, Since July 1, 2010

Indiana passed its Safe Act statute with an effective date of July 1, 2010. Originally, the following regulation appeared to draw land contracts into scope of the Safe Act:

"Mortgage transaction" means a loan or consumer credit sale in which that is or will be used by the debtor primarily for personal, family, or household purposes and is secured by a mortgage, **or a land contract**, or other equivalent consensual security interest on a dwelling or residential real estate.

(emphasis added).

Sometime in July 2010, Indiana proposed a new regulation that deleted the term “land contract” from the definition of a “mortgage transaction.” The new definition reads as follows:

"Mortgage transaction" means a loan or consumer credit sale that is or will be used by the debtor primarily for personal, family, or household purposes and is secured by a mortgage or other equivalent consensual security interest on a dwelling or residential real estate upon which is constructed or intended to be constructed a dwelling.

Clearly, the term “land contract” was deleted from the regulation. However, the question is this: ***Is the definition of a “mortgage transaction” still broad enough to include land contracts?***

In an effort to get this question answered, a number of lawyers and real estate brokers have contacted the Indiana Department of Financial Institutions and have spoken with Jim Harrell, Assistant to the Supervisor-Consumer Credit, about the applicability of the Safe Act to land contracts. What this author has been told is that Department of Financial Institutions deleted the term “land contract” from the regulations, because the Department of Financial Institutions believes the statute should only apply to transactions where title to the real estate has transferred to the consumer-borrower.

A Word of Caution

This author has concerns that the Safe Act is so broadly written that future regulators could apply the law to land contracts, or at least argue that land contracts fall within the scope of the law. We should assume that neither Jim Harrell nor anyone else from the Indiana Department of Financial Institutions will testify in defense of someone using a land contract in years to come. Nor would this evidence be admissible in an Indiana court.

The new regulations make no mention of title to land transferring as a definitional component of the new law. In fact, with regard to ownership of real property, the terms “title,” “transfer,” and “deed” appear nowhere in the new regulations. There is arguably no language in the Safe Act or Indiana law supporting the interpretation given by the Indiana Department of Financial Institutions.

Under the new regulations, the term "loan" still includes “the creation of debt by the creditor's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor; or the ***extension of credit by a person who engages as a***

seller in credit transactions primarily secured by an interest in land.” That language sounds like a land contract to many real estate lawyers.

The new regulations do not **exclude** land contracts. Nor does the statute or regulations contain any language distinguishing situations where title has or has not transferred, as part of a “mortgage or other equivalent consensual security interest on a dwelling or residential real estate.” The term “land contract” has merely been deleted from the definition of a “mortgage transaction.”

So, until regulators expressly **exclude** land contracts from the Safe Act, be cautious in the use of land contracts.

Exclusions

There are exceptions under the SAFE Act. Here are a few:

- Selling a home you previously occupied/lived in as your residence.
- Certain clerical and administrative tasks.
- Selling a home to an immediate relative, as defined by the statute.
- Selling commercial buildings, as defined by the statute.
- An attorney who negotiates terms of a residential mortgage loan with a prospective lender on behalf of a client as an ancillary matter to the attorney’s representation of the client, unless the attorney is compensated by a lender, mortgage broker, or other mortgage loan originator or by an agent of such lender, mortgage broker, or other loan originator.

What Is a “Dwelling”

The SAFE Act’s definition of “residential mortgage loan” includes a loan secured by a consensual security interest on a “dwelling” and cross-references the definition of dwelling in section 103(v) of the Truth in Lending Act (TILA) (15 U.S.C. 1601 note). Regulation Z, which implements TILA, defines dwelling to mean “a residential structure that contains 1 to 4 units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence.”

As always, feel free to contact this author for specific answers to your real estate investing and legal questions, or call for a consultation. Good luck and Happy Real Estate Investing.