

ROBERT S. DELANEY

ATTORNEY AT LAW
A PROFESSIONAL LIMITED LIABILITY COMPANY

ROBERT S. DELANEY
Bob@RobertSDelaney.com

3132 EAST EIGHTEENTH AVENUE
SPOKANE, WASHINGTON 99223
FACSIMILE (509) 534-6990
(509) 534-4397

MEMO REGARDING SELLER FINANCED TRANSACTIONS

(Last updated February 1, 2014)

To: Sellers, Buyers, Real Estate Agents and Others

From: Robert S. Delaney, Attorney at Law

RE: Seller-Carryback Transactions for Residential Property Occupied by Buyer ("Seller-Carryback Transaction")

There has been a significant new application of certain state and federal laws regarding ***Seller financed transactions involving residential property to a Buyer who will occupy the property*** ("Seller-Carryback Transaction"). For decades, a Seller could engage in a Seller-Carryback Transaction without difficulty or governmental oversight. This changed significantly on a federal level with the passage of two pieces of legislation. First, the federal SAFE Act which requires the state licensing of individuals who act as residential mortgage loan originators and second, amendments to the Truth In Lending Act brought about by The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). The SAFE Act was followed by amendments to the Consumer Loan Act (the "Consumer Loan Act") and other related statutes following the economic crisis and problematic residential mortgage lending practices that had occurred previously that affected the entire nation.

Under the Washington Consumer Loan Act, the Department of Financial Institutions ("DFI") is taking the position that the Seller in a Seller-Carryback Transaction (by Contract or Note, i.e. "Note") is "extending credit" to the Buyer and is therefore subject to licensing pursuant to the Consumer Loan Act (RCW 31.04).¹ For any Seller-Carryback Transaction, DFI requires the Seller to:

1. Provide certain information regarding the transaction and the Seller's history of selling by way of a seller-carryback transaction;
2. Submit that information to DFI with a request for a License Waiver from the Consumer Loan Act (a "License Waiver"), subject to certain restrictions and conditions; and
3. Obtain from DFI a written License Waiver that, if issued by DFI, will include the following conditions to its validity:

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- (a) The Seller must deliver to the Buyer a written Disclosure Statement (the form is provided by DFI) setting forth the basic terms and conditions of

¹ By contrast, Seller-Carryback transaction for commercial property, where the Buyer will not occupy the property, is not governed by federal or state law, and is permissible without any restrictions, conditions or governmental oversight.

the Seller-Carryback Transaction;

- (b) In order to foreclose the Seller must follow the specific foreclosure process set forth in chapter 61.24 RCW or as otherwise required by Washington law.
- (c) The Seller cannot charge interest to the Buyer that is more than 12% per year.

In November 2013 DFI adopted new rules including a rule on the Seller-Carryback Transactions. The rules take effect on January 1, 2014.² In short, DFI established in rule the criteria for granting a License Waiver to a Seller under a Seller-Carryback Transaction, specifically that DFI will grant a License Waiver to a Seller if the Seller is not subject to the federal SAFE Act and has not been involved in more than five (5) such transactions in a calendar year and agrees to the conditions listed above¹. This was a positive and practical solution to what would have been a very onerous situation for a Seller involved in a Seller-Carryback Transaction. The License Waiver issued by DFI under RCW 31.04.025(3) is a waiver from the licensing provisions of the Consumer Loan Act. The License Waiver does not impact the applicability of the federal Truth in Lending Act to the transaction or the seller's compliance therewith.

Under the Federal Truth in Lending Act the Consumer Financial Protection Bureau (the "CFPB") has adopted regulations on Seller-Carryback Transactions. Under the regulations, which take effect January 10, 2014, Sellers fall into two categories as to the limitations and requirements of engaging in a Seller-Carryback Transaction.

One category of Seller is for those individuals, trusts or estates who do just **One Seller-Carryback Transaction in a 12-month period**. For a Seller in this category³:

- 1. The Seller's Note may call for a balloon payment of the balance owed by the Buyer; and
- 2. The Seller does NOT have to prove or document the Buyer's ability to pay the terms of the Note; and
- 3. The Seller's Note must have a fixed interest rate for five (5) years, and at the end of five years the interest rate can be increased by no more than two (2) percentage points per year, with a cap of six (6) percentage points above the initial interest rate of the Note.

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The other category of Seller includes individuals, trusts and estates that do **More Than One Seller-Carryback Transaction per 12-month period, AND includes LLCs, corporations,**

² The guidelines as to the granting of a License Waiver by DFI include such criteria as: (a) an outright exemption from the SAFE Act applies to the Seller or the Seller was not engaged habitually in such transactions; (b) the Seller did not engage in more than one (5) such transaction in a calendar year; and (c) the License Waiver will be subject to certain conditions that must be adhered to by the Seller (see above as to those conditions).

³ This category of Sellers DOES NOT apply to LLCs, corporations, partnerships or other entities. In this case, the second category of Seller would apply to such entities.

partnerships and other entities (“Entities”) that sell property-even just one- to a Buyer **by way of a Seller-Carryback Transaction**. For a Seller in this category:

1. The Seller’s Note cannot call for a balloon payment of the balance owed by the Buyer; and
2. The Seller **MUST** determine the Buyer’s ability to pay the terms of the Note;⁴
3. The Seller’s Note **MUST** have a fixed rate of interest for five (5) years, and at the end of five years the interest rate can be increased by no more than two (2) percentage points per year, with a cap of six (6) percentage points above the initial interest rate of the Note.
4. If the Seller **DOES NOT** do more than three (3) Seller-Carryback Transactions per year, the Seller does not have to become a licensed Mortgage Loan Originator (“MLO”); but
5. If the Seller **DOES** do more than three (3) Seller-Carryback Transactions per year, the Seller does have to become a licensed Mortgage Loan Originator (“MLO”).

Any Seller, Buyer, Real Estate Agent, and Closing Agent involved in a Seller-Carryback Transaction should ascertain detailed information about the transaction and the Seller in order to assure the Seller that he is compliant with BOTH STATE AND FEDERAL LAW. I recommend that, when drafting a Purchase and Sale Agreement for a Seller-Carryback Transaction, the agreement be contingent upon: (a) Seller applying for and obtaining from DFI a License Waiver from licensing under the Consumer Loan Act; and (b) Seller determining that he or she will be in compliance with the Truth in Lending Act. The DFI License Waiver does not impact the applicability of the Truth in Lending Act.

³ See WAC 208-620-232.

⁴ The regulations do not specify any standards for determining if the Buyer has the ability to pay the terms of the Note. All that is required is that a Seller make some good-faith determination that the Buyer is able to pay the terms of the Note, and no documentation is required. However, it would be prudent practice for a Seller to obtain and retain sufficient documentation to support his or her determination in case of later litigation over this issue. One of the risks of not complying with the Seller Financing restrictions in Truth in Lending is that failure to do so may result in the Seller being deemed a loan originator and then other requirements apply, including the ability to repay analysis. See 12 CFR 1026.36.