Eckley & Associates
An Interstate Law Firm
PHOENIX: (602) 952-1177
TUCSON: (520) 885-8694
PORTLAND: (503) 363-2176
SEDONA: (928) 203-9330
SAN DIEGO: (619) 546-6600
SEATTLE: (206) 232-2749
www.eckleylaw.com
eckley@eckleylaw.com

OVERVIEW OF THE DODD-FRANK AND CONSUMER FINANCIAL PROTECTION ACT FOR REAL ESTATE BROKERS

(SPECIAL SPOTLIGHT: THE ACTS AND OBJECTIVES IN A NUTSHELL, THE NEW QM MORTGAGE, NEW RULES FOR SELLER-CARRIED FINANCING, DEADLY DISCLOSURES, DISCLAIMERS, ARBITRATION CLAUSES, NEW USE FOR MLOs, MARS, MIR AND THE NEW "ABUSIVE PRACTICES RULES)

BY: J. ROBERT ECKLEY
Real Estate, Brokerage, Agency and Banking Attorney

© 2014, THE ONLINE LAWSTORE

March 1, 2014

THE MATERIALS BELOW AND THIS PRESENTATON IS NOT THE RENDERING OF DIRECT LEGAL, REAL ESTATE, INVESTMENT, ACCOUNTING OR LOAN ADVICE AND IS PROVIDED AS A COURTESY TO THE COURSE ATTENDEES FOR GENERAL EDUCATIONAL PURPOSES ONLY. PROPER LEGAL ANSWERS VARY GREATLY FROM CASE TO CASE AND THUS REQUIRE SEPARATE AND DIRECT ANALYSES IN EVERY EVENT. ALL LEGAL, ACCOUNTING AND GENERAL ADVICE SHOULD THEREFORE IN EVERY CASE BE SOUGHT DIRECTLY FROM A COMPETENT, DULY-LICENSED PROFESSIONAL. DOCUMENT DRAFTS ARE FOR EDUCATIONAL DISCUSSION PURPOSES ONLY AND ALL TRANSACTIONS AND DOCUMENTS SHOULD BE REVIEWED, DRAFTED AND ADAPTED TO FIT EACH TRANSACTION AND SITUATION.

A LITTLE BACKGROUND:

DFA/CFPB

The Dodd-Frank Act (the "DFA" July 21, 2010, signed into law by President Obama on July 21, 2010) and the Rules of the new Consumer Financial Protection Bureau (the "CFPB," created by DFA) are nothing less than a revolution in banking and social policy. The DFA restructures the oversight of financial regulation, creates a new "Super Bureau" in the unregulated hands of the Executive Branch of U.S. government called the Consumer Financial Protection Bureau ("CFPB"), assigns to it all of the major consumer law enforcement agencies, grants the CFPB co-jurisdiction to make and enforce most of the consumer protection provisions of the Federal Trade Commission

("FTC") and for the FTC to be able to co-enforce the CFPB regulations and even state consumer laws. The DFA also contains massive regulations and standards as to how the entire banking, securities, insurance and other systemic components and regulation is and will be administered, how the entire financial chain will be capitalized and underwritten, how the financial system with be operated and overseen, sanctioned and coordinated. It also provides significant amendments to the Truth in Lending Act ("TILA"), Housing and Urban Development Administration ("HUD") management and Rules, including changes to the Real Estate Settlement and Procedure Act ("RESPA") operational rules, to name just a few powerful changes in the way the American financial system works. RESPA and other consumer law and agency controls gives the CFPB jurisdiction over title and escrow companies and other settlement services, including attorneys and real estate brokers and all services tied by affiliated marketing agreements of any kind affected consumer transactions.

New market-protective laws like UDAP and UDAAP (see below) give it jurisdiction over ANYONE (not just certain professions) who violate those and other laws or even who act "unfairly…or abusively..or deceptively" in the delivery of a consumer product or service.

The CFPB's jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, foreclosure relief services, debt collectors and other financial companies; through the consolidation in it of the other agencies, it also controls HUD, the FDIC, SAFE and federal securities acts. It was designed to consolidate employees and responsibilities from as wide a number of federal regulatory bodies as possible, including the Federal Reserve, the Federal Trade Commission, the Federal Deposit Insurance Corporation, the National Credit Union Administration and even the Comptroller of the Currency. Overall the enforcement of 14 important financial regulatory agencies and financial laws were assigned to it and it appears to have been granted the enforcement of ANY consumer protection laws, state or federal.

The CFPB is an independent unit located inside and funded by the United States Federal Reserve, with interim affiliation with the U.S. Treasury Department. It writes and enforces rules for financial institutions, examines both bank and non-bank financial institutions, monitors and reports on markets, as well as collects and tracks consumer complaints and prosecutes them or refers them to other agencies to prosecute them, such as other federal agencies, local state regulatory agencies, the local AG's offices, the U.S. Department of Justice and the state and federal revenue services.

The CFPB was given the power to operate by Rulemaking (as opposed to congressional oversight and legislation) placing this massive and pervasive control of the entire American financial system effectively under the directives of the U.S. President. This is a revolutionary change, placing a historically-unprecedented amount of direct financial control of the country in the hands of the executive branch of government.

THE DFA/CFPB/FTC JURISDICTIONAL COMBINATION HAS BECOME A JUGGERNAUT: IT IS A REGULATORY, FISCAL AND FINANCIAL POLICY-SETTER AND ENFORCER WITHOUT PRECEDENT SINCE THE LAPSE OF THE NATIONAL EMERGENCY WAR POWERS ACTS (GIVING THE FED ABSOLUTE CONTROL OF THE ECONOMY AND THOSE IN IT) OF WORLD WAR II. THE REACH OF IT AFFECTS CONSUMERS AND BUSINESS, BANKING, WALL STREET AND MAIN STREET, ALIKE.

SAFE ACT

On July 30, 2008, President 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 ("MLOs"). This agency and authorities have also been granted to the CFPB. Under the SAFE Act, MLO laws will now apply to seller financing in real estate sale transactions and outlines permitted and prohibited acts of all participants in that process (seller, buyers, real estate and mortgage brokers, banks, title and escrow companies, et al.), except to the extent the transaction or act is expressly exempted. The SAFE Act targets for regulation Mortgage Loan Originators and brokers but also includes in it private parties who sell more than a given number of properties on given terms in private financing transactions, treating them as (and requiring them to be or to use) MLOs in their consumer transactions. The rules therefore target not just mortgage brokers and originators, but also seller-carry consumers and their seller-carry loans. By doing that it also sets forth standards of practice for real estate licensees by regulating real estate transactions at the stage where they originate--in their hands at the instant of first consumer contact, through pre-transactional counseling given to the consumer and then at first transactional negotiations. The law identifies an accumulation point of services or types of transactions in which the real estate licensee and parties must involve yet a second licensed professional, i.e. a Mortgage Loan Originator (the "MLO" in these parlances). Under the new acts and in a nutshell, after 3 seller-financed consumer transactions in any 12 month period and for all those over 1 consumer deal per 12 month period or which contain balloons (and other terms, see below), the seller must be an MLO or assisted by an MLO. It is not as simple as this "thumbnail" test, so do see the additional discussion, below.

Licensing of "loan originators" under state laws enacted pursuant to the SAFE Act and meeting minimum federal requirements has been historically required for other more conventional transactions for many years. The new rules, going for the most part into effect January 10, 2014, extend coverage to seller-carried transactions in ways that are new and pervasive.

Many states following by adopting their own versions of the above acts, though, if there is any variance, the federal acts prevail over state law. The sole exclusion to that general rule of federal pre-eminence is set out in the DFA. It indicates that if a consumer protection law of the state and federal acts conflicts, the MORE FAVORABLE LAW TO THE

CONSUMER prevails. **California** adopted most of the DFA (particularly the insurance and securities portions) by SB 1216, signed into law October 2, 2012. **Arizona** has adopted the mortgage licensing portions in 2010-2011. California and several other states have adopted their own more aggressive state RESPA laws. All of the states have their own licensure laws for mortgage, real estate, banking and other activities and all have a matrix of consumer laws in place.

Now, after this review of the legislative developments, a summary of what the new agencies have done to implement themselves and their rules and then on to how this affects some conventional real estate commerce.

FIRST, A LITTLE MORE ABOUT THE ACTS AND ENFORCEMENT ENTITIES:

THE DODD-FRANK ACT

Title XIV of the Dodd-Frank Act (the “DFA”) imposes rules on mortgage originators to promote “responsible, affordable mortgage lending”. The “Qualified Mortgages,” (“QM”) as defined in Title XIV, set forth a new conventional mortgage booking, underwriting, holding and marketing standard and banking standards generally that are applicable to lenders, mortgage brokers, mortgage bankers, banks, thrifts, the GSE’s, the secondary market and others not generally part of a seller-carried finance discussion. Title XIV establishes extremely complex requirements, and the implementing regulations are needed to interpret the law and provide additional guidance. Title XIV did not take effect until final regulations issued by the CFPB went into effect on January 21, 2013, which was when the CFPB had to state the issue of the final regulations. On January 10, 2013, the first of CFPB’s Rules started to come out and many more since. According to the statute, they must take effect no later than 12 months after their issuance, meaning January 10, 2014. Some by terms of the Rules take effect BEFORE then (including some seller-carry rules). As to any part of the DFA statute that the CFPB missed making any implementing rules on, Title XIV’s provisions took effect on January 21, 2013. Quite a number were introduced immediately before then, but the rest evolved over 2013, “going finally hard” January 10, 2014. The QM rules are STILL not “hard,” as they are still being changed almost daily by CFPB rule.

THE CFPB

As noted, the CFPB did issue regulations, commencing January 10, 2013 and it is clear that by January 10, 2014, the DFA and CFPB Rules will govern all seller-carries. There are also rules powerfully limiting what real estate licensees can do to assist certain seller-carry deals. They are at the very least the NEW STANDARDS OF CARE and will play strongly not only in evaluating the legality of the service the principals were given by the professions, but will also play strongly in the discounted valuation of the resulting debt instruments. Sub-DFA debt of DFA-deficient debt will likely suffer a deeper discount than DFA-compliant debt, regardless of when it was generated.

HUD:

"HUD" is the Housing and Urban Development Administration which has massive jurisdiction over all regulations affecting housing and industry and consumer practices associated with housing. The HUD website (where SAFE is explained) has information about the SAFE Act over which it has jurisdiction. HUD regulates all settlement procedures, all consumer financing and real estate financing transactions. HUD first proposed in prior years to regulate ALL seller-carries except the single transaction where a home owner sells his one single personal, owner-occupied home. The National Association of Realtors'® ("NAR") commented on February 12, 2010, on HUD's proposed rule and urged a total exemption for seller financing to provide much needed flexibility at a time when the recovering marketplace fragility needed it. NAR got some but not all of what it asked. HUD did not issue the final regulations until the latter part of 2012. But when the Consumer Financial Protection Bureau (CFPB) went into effect on July 21, 2011 as provided by the DFA, it took over the HUD and, accordingly, took over the SAFE Act, generating more delay and ambiguity in the final rules. THE CFPB did not come down with any definitive rules until October, 2012 (the first battery) and then January 10, 2013 (the second battery). The final rules for seller-carries are now out and discussed, below.

A larger (but still summary) description of the laws regarding seller finance follows. There are many, many fictions, myths and fantasies being spread by the various industries and one must beware of them.

FOCUS: RESPA AND SELLER-CARRIES

Transactions generally not covered under Real Estate Settlement and Procedures Act ("RESPA") include***: "an all cash sale, a sale where the individual home seller takes back the mortgage (seller-carry), a rental property transaction or other business purpose transaction."*** This exclusion does not excuse the non-disclosures of fees and costs on the HUD-1 under the rules or Affiliated Business/Marketing Agreements and state licensure rules. NOTE: Despite RESPA Section 8 the CFPB has labeled Affiliated Business/Marketing Agreements as its "Public Enemy Number 1" and has even recently seem to win a federal Appeals Court decision in which it declared the 10-point HUD test for lawful marketing agreements constitutionally invalid, reopening that once safe harbor to re-interpretation —likely a more strict one than formerly--by the CFPB.

FOCUS: THE "MORTGAGE LOAN ORIGINATOR""

The CFPB released the original MLO rule on January 20, 2013, as part of its implementation of amendments to the Truth in Lending Act (TILA) as authorized and granted to the CFPB by the DFA. The rule took effect on June 1, 2013. 1 See 12 CFR section 1026.36.

The new Rules provide in general that only licensed "Loan Originators" (usually called a Mortgage Loan Originator or "MLO") can examine or

determine the borrower's credit or approve certain buyer's or sale terms in most consumer residential seller-carry transactions except one-time, single property, isolated sales of a family residence, otherwise, outside of some "safe harbors" noted below, the transaction itself is voidable and those who facilitated it without being an MLO are in violation of the rules (potential civil and criminal penalties).

The new Final Rule establishing "Loan Originator Compensation Requirements" not only covers the new "loan originator" definitions, but also sets allowable fees. The Rule applies broadly to loan originators, including seller-financers that do not qualify for an exclusion from the definition of "loan originator." One who falls into the definition of a "loan originator" must then comply with strict licensure requirements and underwriting duties. "Loan origination fees," or MLO fees, including all charges, for seller-carries should not exceed 3% of the loan, but in most cases even that amount would not be marketable as, unlike conventional transactions, it is not the MLO's own money resources that are funding the transaction, unless the seller and the MLO are one and the same. What one is getting from the independent MLO in this use category is credit data development, only. Not loan money. In addition, there is no requirement that the independent MLO "approve" the loan. That is up to the seller, solely. The MLO is to develop for the seller an accurate, conventional due diligence package respecting the borrower's ability to repay.

REAL ESTATE LICENSEES UNDER THE SAFE ACT:

Real estate licensees engaged **solely** in "real estate **brokerage activities" as defined by their licensure laws and engaged in normal loan-related activities incident to selling and buying real estate and not charging a fee for the loan services are not considered to be acting as MLOs**. For instance, the referral of a buyer to a lender to apply for credit in a home purchase or to a seller who will carry contract in the ordinary course of business is not loan origination. Loan origination for a fee is not, however, one of those exempt brokerage activities. See relevant state licensure law and also see 12 CFR Section 1026.36. This also does not permit real estate brokers or escrow to draft the actual seller-finance loan documents. LAST, IT DOES NOT MEAN REAL ESTATE LICENSEES ARE EXEMPT FROM THE CFPB JURISDICTION. Se below.

Since sometimes the distinction between "real estate broker activity" and "MLO activity" can be obscure, the CFPB has provided guidance clarifying that compensation paid by a creditor or loan originator to a real estate broker/agent does not transform a real estate brokerage activity into a loan originator activity. See RESPA.

The CFPB explains:

1 A person paid solely for real estate brokerage activities by a loan originator or creditor is not covered by the definition of loan originator.
2
3 When a real estate broker/agent sells a property owned by a creditor (such as an REO), the commission does not turn the real estate brokerage activity into a loan originator activity.

But care is needed. CFPB also notes:

1 Even if State law provides that loan origination activities are eligible real estate brokerage activities, the real estate broker/agent is nevertheless considered to be a loan originator under the final rule if engaged in loan originator activities as defined under the final rule—federal law superseding state law.
2
3 A broker/agent is a loan originator when paid for performing creditor, mortgage broker, or consumer credit referral activities.

4 If a broker affiliated with a creditor pays an agent for origination activities, such as for taking the consumer's credit application and performing other functions related to origination of the loan, the agent is a loan originator.

After making the general statements, above, there are some exceptions and qualifications.

A BROAD DEFINITION

The definition of a "loan originator" is now very broad. It covers **anyone** who, for compensation, performs any activities related to the origination of mortgage loans, including (but not limited to): taking an application or offering, arranging, or assisting a consumer in obtaining or applying for credit. This means both non-consumer and consumer loans.

TILA, as amended, and CFPB's implementing regulations exclude from the definition of loan originator some sellers who provide seller financing, but only if they meet narrowly-defined exclusions (below). Because the requirements are extremely complex, unless seller-financers qualify for exclusion, they will as a practical matter have to add other players to the approach for seller-financing the sale of the property, including engaging a licensed loan originator ("MLO") in most all consumer transactions in which the seller has sold more than a single property in any given year without risking penalties for performing loan origination activities themselves. This is similar to the situation under the SAFE Act's loan originator licensing requirements where, unless one is exempt from licensing under the state law

enacted to implement the SAFE Act, it is not usually practicable to provide seller financing directly without an MLO. Most state licensure laws allow the real estate licensee to assist in putting deals together which involve finance as part of ordinary and normal real estate activities. None of them permit the real estate licensee to act as an MLO or to act as an approver or denier of credit in the real estate transactions of others.

ARE REAL ESTATE LICENSEES "EXEMPT" FROM DFA/CFPB RULES AS THE INDUSTRY LOBBIES ARE SAYING? GOOD GRIEF, NO!: The real estate industry is spreading the myth that real estate licensees are expressly exempt from the new DFA/CFPB rules and that self-serving contention is FALSE. They point to Section 1027 of the DFA in pertinent part where is says: "... (b**) Exclusion for real estate brokerage activities**...(1) Real estate brokerage activities excluded.." from jurisdiction. Unfortunately, that is usually where the quotes stop and there is much, much more in the statutes and rules. A few paragraphs later the same Section goes on to state: "... (2) [notwithstanding paragraph (b) (1) above].. (t)he Bureau may exercise rulemaking, supervisory, enforcement, or other authority under this title with respect to a person described in paragraph (1) when such person is- **(A)** engaged in an activity of offering or providing any consumer financial product or service, except that the Bureau may exercise such authority only with respect to that activity; or **(B)** otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H, but the Bureau may exercise such authority only with respect to that law.

Thus, although this subsection of 1027 is titled "exclusion for real estate brokerage activities," Congress made an end-run around the real estate broker community later in the statute when it elaborated to state that the "exclusion" [sic] DOES NOT limit the CFPB from exercising rulemaking, supervisory, and rule enforcement over real estate agents or brokers where they offer ***any*** consumer financial product or service or act in violation of **any consumer law** that has been transferred to the CFPB for enforcement (and the CFPB has been transferred most of them). Senate Report 111-176 makes that clear when it provides the following insight to section 1027: real estate brokerage activities are **covered and are under CFPB jurisdiction** to the extent that a real estate broker is engaged in the offering of a consumer financial product or service or is otherwise subject to any enumerated consumer law or any transferred authority. The Senate Report is a simple restatement of the DFA's language and implies that the DFA means what it says: real estate agents and brokers fall under CFPB power but that the CFPB was not created specifically become *the* agency dedicated to regulating real estate brokers or agents. Presumably state agencies that license and promulgate their own rules are still primarily (but along with CFPB jurisdiction not the agency exclusively) tasked with the direct general regulation of their licensees.

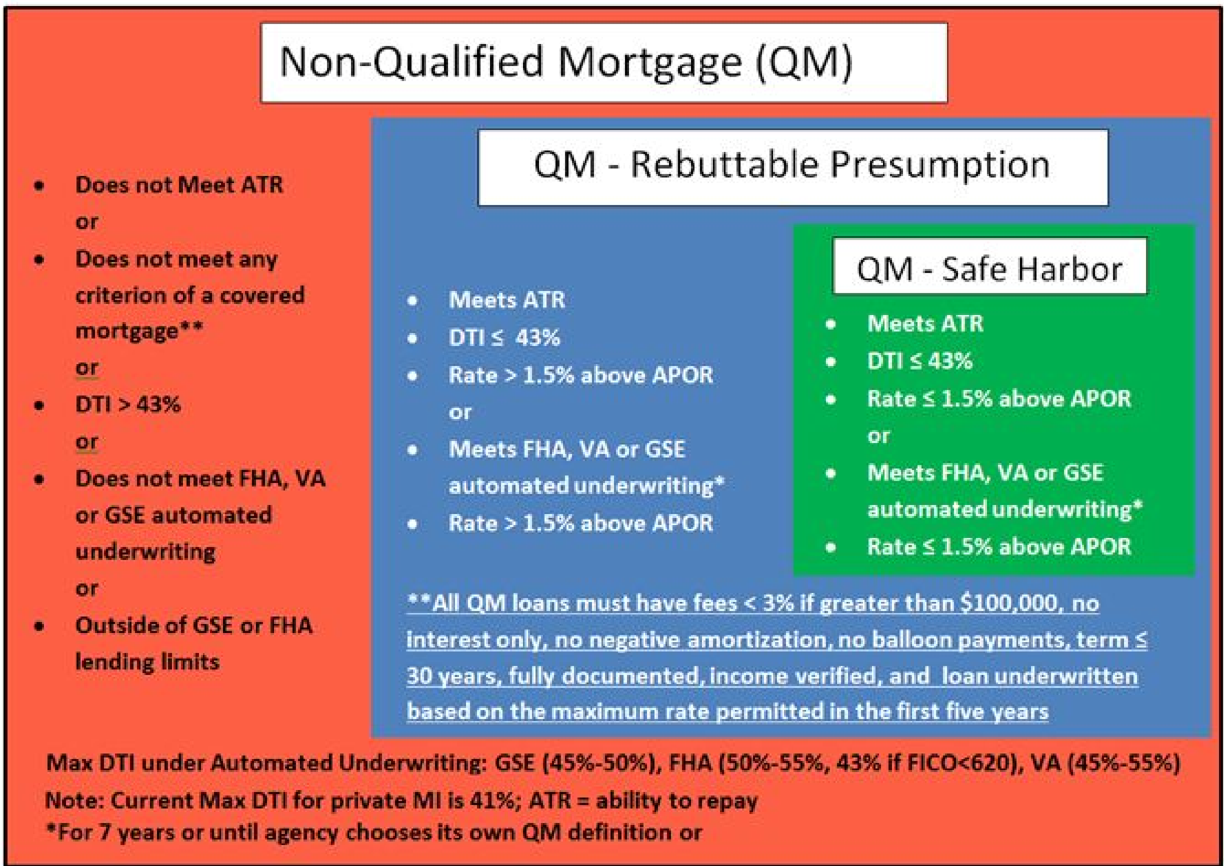
A good example: Associated business arrangements ("ABAs") between real

estate brokers and mortgage brokers engaged in consumer lending are expressly under the jurisdiction and enforcement power by the CFPB because the regulating agencies are now consolidated under CFPB control. HUD and RESPA enforcement are assigned by the DFA to the CFPB and RESPA specifically recites that it applies to all persons provided “settlement services” and specifically enumerates “real estate brokers” (if it is an consolation, it also specifically names “attorneys” as under the penumbra, as well).

The real estate broker representative communities lost the battle to exempt themselves from the CFPB. That was not surprising considering that these new laws were the most “steam-rolled” Congressional juggernaut in recent history. But perhaps embarrassed, the licensed real estate industry has published dis-serving dis-information that the lobbies “won an exemption for the brokers.” They did accomplish some things good for the brokers and even consumers, but they did not, however, accomplish an “exemption”. Real estate licensees are under the rules and must, then, know and heed the rules.

THE NEW “QM” 2014 RESIDENTIAL LOAN CRITERION

There is a fairly persuasive argument that the new “QM” mortgage loan standards and limits commencing after January 10, 2014, are so onerous that they are going to breed a new wave of seller-carried finance. Large jumps in seller-carried real estate transactions are already evident in the marketplace—some, like areas in California, going from .5% to 8% of the residential marketplace in the last year. The QM rules are below and ought to be reviewed by anyone whose business relies on the fluctuations of this marketplace. The “QM” is brand new and, in general, tends to raise down payments, reduce borrowing capacity, increase qualifying credit scores and reduce values. A residential market dominated by “miserly finance” will tend to depress numbers of listings and sale values. At the same time, it can also disqualify or discourage new homebuyers and drive them to rentals, increasing rental and multifamily housing incomes and values, which, unlike owner-occupied property, function on cap rates. See the new “QM” standards, below. Caveat: It is likely that an entirely new matrix of subprime financing could come to the rescue through a “loophole” in the DFA/CFPB oversight. See more, later, below.



LOAN CEILINGS: Interpreting the chart, above, the Qualified Residential Mortgage, or "QM," lays out basic requirements for lender underwriting. These are for GSE-limit loans, meaning loans not to exceed a U.S. maximum (2013) of $729,750 (this was recently lowered to $650,500 for 2014), but as further lowered by a formula for each local jurisdiction —calculated as 125% of local median prices in each U.S. metro area. Jumbos (usually above the local ceiling where the local ceiling stops before $650,000) still qualify as a QM, but may not be purchased by the GSEs and would have to go to the private market. Super-jumbos (complexly outside of the GSE limits and jurisdiction, so usually defined by the internal policies of the issuing lender, now commonly starting at $1.1 million and above, but median averaging $5-$10 million) are proprietarial, many times portfolioed by the lender or investor and are usually are so customized to the borrower and collateral that they do not meet generic QM qualifications and are thus excluded entirely from current QM ratings. Even if they meet the other QM standards, there are limited placements for them and thus implicitly they appear for the time being to be "Non-QMs" in fact and practice if vague in regulation. Between the Non-QM status and the federal Home Owners' Equity Protection Act ("HOEPA") limitations, hard consumer-loan mortgage money is mostly gone.

BORROWER'S ABILITY-TO-REPAY: For those under the QM ceiling and in short, the originator of the loan must verify all sources of income and assets and verify that the borrower has the ability to repay the mortgage (ATR) and that with rate the consumer and the loan as "QM" ("the loan of the Gods") or a "Non-QM" (a loan having a close affinity with "Financial Satan"). A number of loan types are prohibited per se from receiving the QM status, including those with negative amortization, balloon payments, interest-only features, as well as those with durations greater than 30-years. Finally, there is a cap on fees that lenders can charge of 3% (with an exception for loans under $100,000) and the back-end

debt to income ratio (“DTI”—the combination of the principal, interest, taxes and insurance on the proposed mortgage (“PITI”) plus the borrower’s recurrent debts, including installment debts, open credit (auto loans, student loans, etc.) must be less than or equal to 43%.

RATES LIMITS: Mortgages that qualify as a QM will be further bisected by those that have a rate 1.5% above the prime borrowing rate and those that do not. Loans below the 1.5% will receive special legal status known as a safe harbor, where the borrower in default must first prove that their loan was not affordable when originated in order to sue the lender. If the loan is QM and above the 1.5% rate threshold, then there is a rebuttable presumption where the lender must prove that the borrower had the ability to repay. Under the rebuttable presumption, even if the lender can prove the loan met the borrowers “ability-to-repay” standards (“ATR”), the lender incurs legal costs making the case of $70,000 to $110,000.

THE EFFECT: *A*ccording to some industry analysts, while other analysts argue that the incidence of claims would be extremely low on these, *i*f the lender cannot demonstrate that the borrower had the ability to repay, then the lender faces new enhanced legal fees. Furthermore, the borrower’s ability to fight the foreclosure of this kind of a mortgage applies for the life of the loan, which would extend foreclosure timelines, increasing costs to banks. Lending outside of either definition of a QM may be sparse as the lender would have to raise rates further to compensate for litigation risk since these would fall outside either definition of a QM loan; these higher rates might then reach the limits set by the federal Home Owners’ Equity Protection Act (“HOEPA”--HOEPA does not permit lenders to over-reach with oppressive mortgage terms and other restrictions—but that is a discussion for another day or article in the present context).

SO WHO WILL BE IN “NON-QM SIBERIA”?

- Jumbo loan users with DTIs greater than 43%, which is estimated to be roughly 0.5% to 1.0% of the entire market; super-jumbos are implicitly wounded (and will be hard to find) for all but those who really do not need to borrow the money or are granted them as “perks” to a wider and more lucrative banking relationship with the customer, or come from hard-money lenders who can find acceptable profit in skating narrowly under the rate caps and HOEPA rules and who must logically be asset-based lenders, as most high income or high net worth borrowers will not need to use hard money.
- Mortgages where fees are greater than the 3% cap – this is difficult to quantify, but it could be a large portion of the market. Still, lenders can “pay for” some costs by including them in a higher rate, so long as it is under the 1.5% cap, thereby ameliorating the impact to the market.
- Borrowers who use interest-only or negative amortization loans. Some estimates have this portion of the market in the range of 15%. However, this type of financing is commonly used by wealthier individuals with large reserves who can shift to different financing options.
- Borrowers with interest rates 1.5% or more above the average prime borrowing rate are roughly 4.9% *of* the purchase market and just 0.04% of the jumbo segment. Some borrowers in the conforming space may be able to shift to FHA, which is seeking an exemption to this point, but more borrowers may be pushed into this space if banks finance origination costs to comply with the 3% cap.
- The subprime market will be more restricted. The FHA will likely be the only option for borrowers with a FICO less than 620 and DTI over 43% as the FHA recently rescinded the ability to process these loans through automated underwriting. Most will need to start in the 700s and the jumbos and jumbo-plus in the 800s.

JUST RELEASED FROM CBPB: THE CFPB has announced (October 10, 2013) that for the QM-Plus and the QRM, the new down payments after January 10, 2014 will be 30% !!! Expect that to get deferred or changed, but what it does tell us is the seller-carries are going to be seen more in the immediate future!

Now to turn to those rules governing seller-carries.

ALL ABOUT SELLER-CARRIES!

NEW RULES FOR SELLER-CARRIES IN A NUTSHELL: The new rules will govern seller-carried residential finance using a trust deed, mortgage, land sale agreement, land trust agreement or like financing tool where a purchaser's title of any kind is vested in the buyer and the buyer intends to use the property as a personal home and not as investment or business property. The rules require that some due diligence steps are taken by almost all of the professionals in the transactional chain to assure compliance—in some cases that the creditworthiness of the buyer is determined and that the credit information is put before the seller so that the seller and his or her advisers can make a well-based and reasoned decision to extend a loan to the buyer--and the rule goes on then to limit the terms of the loan the seller can demand, depending upon how many properties the seller has sold in any 12 month period (looking back and forward). For most "mom and pop" one-time-only home sellers, there are "some" exclusions from these rules for them and the professional transactional participants.

Before one concludes that this is an "onerous development" in the law, one ought to consider the fact that assuring the borrower is creditworthy and assuring that the seller and seller's qualified advisers knowledgeably weigh the borrower's ability to repay and consider sound terms for the financing has ALWAYS BEEN THE RIGHT PROTOCOL for seller-carried transactions. IT HAS LONG BEEN A REAL ESTATE AGENT'S DUTY TO SEE TO IT THAT THIS HAPPENS (THOUGH NOT NECESSARILY TO CONDUCT ALL OF THE REQUIRED DUE DILGENCE)! WARNING CAVEAT: ITS IS NOT THE AGENT'S DUTY OR EVEN THE AGENT'S "RIGHT" TO GATHER CREDIT OR MAKE CREDIT RECOMMENDATIONS OR DETERMINATIONS. IT IS INSTEAD THE AGENT'S DUTY TO ASSURE THE SELLER AND BUYER GET THAT INFORMATION FROM <u>COMPETENT THIRD-PARTY SOURCES</u>. PASSING A CREDIT OPINION TENDS TO MAKE THE AGENT A "GUARANTOR" FOR THE DEAL AND IN SOME CASES NOW VIOLATES THE NEW RULES AND EVEN FAIR CREDIT ACTS—A VERY RISKY SPOT TO BE IN!

<u>A WARNING: THERE IS STRONG AND AUTHORITATIVE LEGAL ANALYSES THAT SUGGEST THAT CAR's (California) and AAR'S (Arizona) NEW SELLER-CARRY ADDENDUMS STILL DO NOT ACCURATELY RECITE OR COMPLY WITH THE CFPB/SAFE RULES! CONTINUE TO USE A COMPETENT ATTORNEY WELL-VERSED ON THESE AND RIGHT UP FRONT ON YOUR DEALS BEFORE CONSUMMATING IT THROUGH AN</u>

AAR RESIDENTIAL SALE AGREEMENT USING THESE FORMS. MOST ATTORNEYS IN THIS AREA OF PRACTICE HAVE THEIR OWN COMPLIANCE FORMS!

THREE-STEP LITMUS TESTS IN SELLER-FINANCING ANALYSES AFTER JANUARY 10, 2014

After January 10, 2014, there have been three tests required for the consumers, licensees and other entities to consider in the "listing-to-sale-to-buying-to-financing-to-closing process" to comply with the CFPB/SAFE Act. All in this chain (real estate broker to mortgage broker or banker to appraiser, if any, to inspector, if any, to escrow) are responsible to know them and apply them and not to participate in a transaction or an act that violates them or "furthers" a wrongdoing earlier in the transactional stream. For the discussion, below, of this basic 3-test list, all of these entities—seller and buyer, real estate licensee, real estate brokerage, Mortgage Loan Originator or mortgage broker, any lender, title insurer and escrow company and all managing or participating persons and assignees—will be collectively referred to as "Transactional Participants." If there is an exception for the **seller-carry regulatory coverage**, the exception from those rules (remembering, of course, that all Participants may have other rules that apply to them) is good for all Transaction Participants. ***If there is not an exception, then compliance by each Transactional Participant is the burden of all Transactional Participants.***

FIRST TEST: ***Is the transaction a "consumer transaction?" If it is not, the seller is outside of the rest of the tests and outside of the SAFE Act and the CFPB and the consumer analyses for seller-carried finance is over. Whether or not the proposed transaction is a "consumer transaction" is a critical "first test" as most commentators are mis-quoting or mis-interpreting it. The Transactional Participants need to assure that it is not mis-stated and that the correct rule is followed as a matter of appropriate advice, disclosure and professional practice.***

SAFE does **NOT** state that it applies to **all** seller-carries or all transactions in which a residence or dwelling (1 to 4 units) is sold or to all sellers or all sellers over 3 properties a year or all transactions in which the buyer is an individual, though these are commonly explained by commentators as the threshold. Those analyses are WRONG.

SAFE specifically states that it applies ONLY to CERTAIN mortgage transactions. To-wit: A "*mortgage transaction,"* which means a credit or loan transaction for the sale of a collateral that is or will be (1) **used by the debtor primarily for personal, family, or household purposes** <u>**and**</u> (2) is secured by a mortgage or equivalent consensual security interest on (3) a dwelling (4) <u>or</u> residential real estate. THE UPSHOT? If this is a purchase for **commercial or business purposes by the borrower,** a non-"consumer"

transaction, i.e. the buyer is buying for investment or business purposes and not for personal or family occupancy in whole or in part, now or later, this part of the CFPB/SAFE Act does not cover the transaction and the rest of the tests do not apply and the Transactional Participants then need only comply with other laws governing commercial deals. All non-residential transactions such as sales of bare land, commercial and industrial buildings and businesses opportunities—even where a residential property is inclusive but only incidental and a minor element in the deal (such as a watchman's residence on the property)--are exempt from and outside the CFPB/SAFE Act. Manufactured homes can be inclusive if they meet the other residential tests. In addition, seller-carried agricultural transactions in which a residence is incidental and a minor element are exempt (farm-hand housing on a corporate farm). There are other exemptions and "qualified exceptions." But these are the basics.

Assuming that under the first test above, one continues to remain inside the Safe Act and CFPB regulations as a governed transaction, i.e. a "consumer transaction." then one goes to the second test.

SECOND TEST: ***This test looks at the transaction financing instrument and asks "is the installment purchase/finance agreement to be used with a "consumer party" covered by CFPB/SAFE Act?" (And only because there is so much confusion on this specific question) "as to the financing instrument, is something like a land sale contract exempt? Is a bare lot on which a dwelling is to be built exempt?"***

Discussion: Some financing methods and land types are inside or outside of SAFE/CFPB coverage though they may not look like they are inside because of the borrower's purpose, above. Generally, though, the CFPB/SAFE Act **does** apply to sellers if even if they don't directly "lend" purchase money funds, but merely carry back installment-paid paper, generally to be considered as a purchase debt repaid in 3 or more installments. And it can even apply to bare lots on which a home is intended to be built, but not so if a residence or dwelling is not intended to be built. It also does not apply to agricultural properties or business opps where a dwelling may be the non-primary part of the collective property being sold under a single agreement. The definition of the type of paper and what it is secured by to be under the new rules may also exempt it and is specifically addressed in HUD's Final Rule (and HUD is now under the CFPB). The below is from SAFE:

A "residential mortgage loan" includes an **installment sales contract**. "Residential mortgage loans," as defined by section 1503(8) of the SAFE Act, refers to typical financing mechanisms such as mortgages and deeds of trusts. But in addition, the SAFE Act definition also includes "**other equivalent consensual security interest on a dwelling** (as the term 'dwelling' is defined by section 103(v) of TILA) or residential real estate upon

which is constructed or intended to be constructed a dwelling,”) which has the potential for including a broad range of other financing mechanisms. For the purpose of this rule, “equivalent consensual security interests” specifically include **installment sales contracts,** consistent with the treatment by many states of such contracts in the same manner as mortgages and purchase money mortgages offered by sellers of residential real estate." Installment sales contracts are varying called “land sale contracts,” “contracts for deed,” and other names, but they are all the same. They are widely used for seller-carries because they contain both the language for a sale (critical sale terms, conditions, property disclosures and disclaimers and the like which just finance language does not contain) **and** the language of finance (“I owe yous”) whereas most trust deed and mortgages contain only the language for finance.

More Points on Use of Installment Contracts: In many states installment sale contracts are STATUTORY and a non-judicial foreclosure on them is conducted like that on a trust deed and a judicial one is exactly like one on a mortgage. The "equitable title" argument fails to avoid the CFPB. The "security interest" could be the retention of a "lien secured by possession of legal title until performance is complete,” very similar to a financed vehicle title. And if it was true that an equitable holder had “no color of any title” at all, the casualty insurers would not insure it, title insurers would not insure it and liens through a creditor's bill could not attach to and execute on it and no homestead exemption would apply to it, where such exemptions are otherwise available. Moreover, most title insurers will not insure foreclosure of an installment sale agreement unless all third-party lienors who arise by, through or under the buyer’s “equitable title” are also joined, the same way as required for a “legal title” in which buyer has deed, such as in the case of a mortgage or trust deed in a lien-theory state.

Paperwork Exceptions: Interestingly, this definition does not appear to cover a **lease/option** (one in which a buyer’s duty to buy and an amortization satisfying the price is NOT consummated at the first transactional closing) though it likely applies to a **lease/purchase** as in that case a buyer’s duty to buy and an amortization of the price IS consummated at closing. Also, the purchase of a bare lot which is not intended to have a dwelling built on it would be excluded. The definition would not cover **unsecured options** conveying neither a legal or equitable title. It also may not cover certain **land trusts**, where the buyer has been deemed to have neither a legal nor an equitable title during the purchase period (having merely a “springing interest” after the “condition precedent” of paying in full) and is indebted by an unsecured promissory note. As has already been noted, if the lien is not for purchase (merely a lien for a cash loan, like a business loan or line of credit), or the collateral is not the regulated type (not residential land or dwelling) or the buyer is not buying for personal, family or household purposes, the SAFE/CFPB rules for seller-carries do not apply,

anyway. Interesting

Documentation Caveat: Is a preliminary agreement to purchase, such as those commonly published by Realtor Associations, varyingly called “Residential Sale Agreements,” “Residential Resale Agreements,” “Earnest Money Agreements” or other titles an “exempt transaction or document” under the SAFE/CFPB rules? Short Answer: No. If the parties and terms meet the above, they must comply. Particularly the “Seller Finance” sections, whether inside the agreement or as an addendum! Do all now currently comply? No! Despite what many trade Associations and spokespersons may be saying about CFPB/SAFE Act application and their own documents, many do not comply and the “my association said it was okay and even drafted the non-compliant papers defense” is no defense at all to the CFPB/Safe Act Rules. Transactional Participants are best advised to have their own attorneys review ALL of the transactional documents, whether or not they originated with the Participant.

The Seller Caveat: If the seller sells only one property on consumer finance every 12 months and is other than a natural person, estate or trust, the seller is NOT excluded from the SAFE Act Safe Harbors and will otherwise be restricted to the terms for 2-3 sales per 12-mont period, below, irrespectively of whether the seller would otherwise qualify; if the seller sells 2-3 properties on consumer finance in any 12 month period, and whether or not he is a natural person, corporation, partnership, proprietorships, estates, and trusts, the seller is NOT excluded from the SAFE Act Safe Harbors, below.

THIRD TEST: Assuming that after the above tests, the transaction is still CFPB/SAFE Act-regulated, then which regulatory rule of three applies? Is it: (1) The “single-sale-per-any-12-month-period” rule, or (2) the “more-than-one-but-less-than-four-sales-per-any-12-month-period” rule, or (3) the “four-or-more-sales-in- any 12 month-period” rule? *IN THIS LAST TEST, THE ANSWER AS TO WHICH RULES APPLIES IS A FUNCTION OF TRANSACTIONAL TERMS. SAID ANOTHER WAY, THE RULES SET FORTH “SAFE HARBOR” ALLOWABLE TRANSACTIONAL TERMS. IF THE TERMS DESIRED ARE OUTSIDE OF THOSE “SAFE HARBORS” THEN THE USE OF AN MLO IS REQUIRED,*

See how each of these Rule Brackets apply, below.

If the transaction is a regulated transaction, the Transactional Participants are responsible to assure it and all parties in it meet the rules.

In general the New CFPB Rules provide as follows:

THE NEW CFPB RULES FOR SELLER-CARRIES (SALES CLOSED AFTER JANUARY 10, 2014)

The Basic Rule

The basic rules of seller-carries is now this:

1. **Provided that certain “safe harbor” financing terms and limits are met, and provided that one seller does not sell more than 3 seller-carried residential properties in any 12 month period and provided further than the seller is not the builder of the dwelling sold, the use of Seller-Carries to finance consumer transactions are permissible <u>without the use of an MLO.</u> But..**

2. **If the one seller conducts more than 3 seller-carried consumer finance transaction in any one 12 month period or is the builder of the dwelling sold or if the terms of the financing exceed the “safe harbor” terms and limits, <u>use of an LOM is required</u>. Notwithstanding..**

3. **Irrespectively of the foregoing, the seller and buyer may elect to use an MLO in a seller-carried transaction if they wish.**

More explanation on this seemingly complex topic…

THE ONE PROPERTY PER 12-MONTH PERIOD MLO EXCLUSION

This is the most flexible exception and applies only to a more narrow definition of “persons” (only natural persons, estates, and trusts) that sell only 1 property in a 12-month period. The exclusion is not available to other organizations, such as corporations, partnerships, or proprietorships. To be exempt from the definition of loan originator using the 1-property exclusion, one must meet the following criteria:

1 A. The seller provides financing for the sale of only one property in any 12-month period. The property must be owned by the seller and serve as security for the financing.

1 B. The seller has not constructed, or acted as construction contractor for, a residence on the property in the ordinary course of business of the seller. (This is the same requirement as applies for the 3-property exclusion.)

C. The seller provides seller financing that meets the following requirements:

1 1. The financing has a repayment schedule that does not result in negative amortization. A balloon mortgage is permitted. (NAR sought relief from the prohibition against balloon mortgages.)

1 2. The financing has a fixed interest rate or an adjustable interest rate. If it has an adjustable rate, it must have reasonable annual and lifetime limits on rate increases and provide for the rate to be determined by the addition of a margin to an index rate based on a widely available index such as indices for US. Treasury securities or LIBOR. CFPB’s Official Interpretations note that an annual rate increase of up to 2 percentage points is reasonable. A lifetime cap of 6 percentage points, subject to a minimum floor and maximum ceiling up to any applicable usury limit, is

reasonable. (This is the same requirement as applies for the 3-property exclusion.)

If a seller sells one property using the less restrictive exclusion rules of a 1-property sale, above, then that seller is unable to sell another within 12 months of the first sale without sanctions, as the first sale then count and the 2-sales per 12 month period would not qualify for the more astringent standards of the "more-than-one-sale-every 12 months" exclusion. Thus, if the seller sells under the 1-property rule, above, the single-sale exclusion, then seeks to sell a second property, the safest course would be to wait for the expiration of 12 months after consummation of the first sale before selling the second property. The only other option for the seller if there was any doubt which exclusion to use would be to routinely quality even a 1-property sale under the 3-sale exclusion, since in that case the second sale and even third sale is always permissible inside the 12 months and none of those would then invalidate the first sale's compliance. Though the CFPB made minor changes to the statute, such as the one property exclusion noted above and not requiring proof of documentation of a borrower's ability to repay, the Bureau determined to not eliminate the criteria in the seller financing exclusion as defined in the Dodd-Frank Act. Accordingly, credit verifications and ability-to-pay evaluations should continue to be made.

THE THREE-PROPERITES PER 12-MONTH PERIOD MLO EXCLUSION:

This exclusion applies to "persons" as defined broadly under TILA to include not only "natural" persons but also a wide range of organizations such as corporations, partnerships, proprietorships, estates, and trusts. To be excluded from the definition of loan originator using the 3-property exclusion, one must meet all of the following criteria:

1 A. The seller provides financing for the sale of 3 or fewer properties in any 12-month period. Each property must be owned by the seller and serve as security for the financing.

1 B. The seller has not constructed, or acted as construction contractor for, a residence on the property in the ordinary course of business of the seller.

1 C. The seller provides seller financing that meets the following requirements:

1 1. The financing is fully amortizing (no balloon mortgages or negative amortization).

1 2. The seller determines in good faith that the consumer (buyer) has a reasonable ability to repay ("ATR"). The regulation does not require documentation of the determination, which significantly eases the regulatory burden, though CFPB points out it may be a good idea in the case questions arise whether the seller made the determination. CFPB's Official Interpretations of the regulation provide guidance on how a seller could make the determination that the buyer has a reasonable ability to repay. This could include considering earnings as evidenced by payroll or earning statements, W-2s, etc.; other income from a federal, state, or local agency providing benefits and entitlements; and/or income earned from assets (such as financial assets or rental property). The value of the dwelling may not be

considered as evidence of the buyer's ability to repay. The seller may rely on copies of tax returns. The use of an MLO to aid the seller to develop the ATR due diligence (using conventional methods and data) is considered to be per se compliance with the ATR Rule by the seller.

1 3. The financing has a fixed interest rate or an adjustable interest rate that is adjustable after 5 or more years. If it has an adjustable rate, it must have reasonable annual and lifetime limits on rate increases and provide for the rate to be determined by the addition of a margin to an index rate based on a widely available index such as indices for U.S. Treasury securities or LIBOR. CFPB's Official Interpretations note that an annual rate increase of up to 2 percentage points is reasonable. A lifetime cap of 6 percentage points, subject to a minimum floor and maximum ceiling up to any applicable usury limit, is reasonable. These "safe harbors" are not mandatory, but sellers would be wise to adopt them.

In any of the above cases, the seller should verify the borrower's ability to repay (see below) and when an MLO is used, that is essentially what the MLO does. ***In cases where the seller's terms do not meet the "safe harbors" of the above, they are prohibited from doing the deal unless an MLO is involved***. Recall that when an MLO is needed, the acts do not say that the seller needs to be the MLO. It is just that an MLO must be engaged to assist in the transaction in the limited manner set forth, below.

USING THE MLO OPTION

Obviously, the other option is to engage an MLO to qualify the transaction in any and all events. The MLO review always qualifies the transaction under the CFPB/SAFE Act as Safe Act compliance. Note: Though the MLO involvement "qualifies" the transaction as compliant, the MLO is not required to guaranty to pass an opinion on the likely performance of the borrower—the MLO can do that, but is not required to. The MLO in the seller-carry is required to simply develop and accumulate accurately all of the personal, financial and credit data upon the borrower that would be the case in a conventional loan and provide it to the seller as the seller is the "lender" in the transaction. The data does not have to include a property appraisal unless the transactional terms the parties have arrived at call for it. In any event, unless the MLO has contracted otherwise with the seller, the MLO does not elect to make the loan or dictate loan terms (unless they violate the consumer laws)—the seller makes that decision. The MLO will assist with a Good Faith Estimate ("GFE") where required and will generate a Truth-in-Lending Statement ("TIL") where required and will assist escrow with the new HUD-1s the CFPB/HUD requires (which now must explain variations between any estimated loan rates and transaction cost and the actual, final transaction rates and costs and give the borrower a 3-day review period prior to closing escrow initially and after any changes). Escrows and Real estate licensees SHOULD NOT act as MLOs and develop this paperwork as in most states they are not licensed for it as part of their other professional or operational real estate sales licenses.

FINANCING DOCUMENTS:

In most states, MLOs, escrow companies and real estate brokers are NOT authorized

to draft the actual closing financing documentation. These should be done by the SELLER's attorneys, as in private transactions the seller is the lender and entitled to make the loan on his terms using his approved paperwork. The real estate licensee also has disclosure duties in addition to those set out by the CFPB rules and other licensure rules and those generally are to (1) explain the risks of seller finance to the parties (seller and buyer) and (2) explain the risk of "wraps" if the seller-carry is one. Escrow and mortgage brokers cannot lawfully and accordingly will not do these for the parties or the real estate brokers. A real estate broker cannot allocate "putting the deal together" to an MLO, as the MLO's licensure will not permit him to engage in the "professional real estate activity" of putting the actual offer and acceptance together not the real estate disclosures required.

HOEPA APPLICATION

Note: If the seller is considered a creditor under TILA because the seller makes 2 or 3 high cost loans under the Homeownership and Equity Protection Act (HOEPA), the seller is automatically considered to be a "loan originator" for purposes of the loan originator qualification requirements in 12 CFR section 1026.36(f) and (g) and any other rules applicable to creditors under TILA. This is true even if one is exempt from the definition of loan originator under the 3-property exclusion. Check with an expert to avoid providing seller financing subject to HOEPA, which imposes many more limits and requirements.

OTHER LIMITS:

Even if the seller is excluded from requiring a license as an MLO or the intervention and assistance of one, the transaction would still be subject to the rule prohibiting anyone from paying a loan originator compensation based on the ***terms*** (such as interest rates) of the transaction (e.g., higher MLO payments for loans with higher interest rates). This would occur if a seller financer engages an MLO to assist with setting up the financing for the seller financing but does not apply if there is no MLO required and used in the deal. In addition, the CFPB limits on mandatory arbitration would also apply, i.e. the contract or other agreement for any credit transaction, including any seller financing, may not require arbitration or other non-judicial procedures to resolve disputes. Sale agreements popular with Forms Committees for many Realtor® organizations that provide for mandatory arbitration in a consumer transaction (a listing, offer, counter, acceptance, buyer broker agreement) might actually violate the new CFPB prohibition against such clauses—one needs to check with the counsel for the Associations issuing forms like that. After a dispute arises, however, the parties may agree on their own as a result of subsequent negotiation to use arbitration or other non-judicial procedure, but it can no longer be boilerplate without options to opt out of that option in the original commitment. There are more rules, but this shows why it is best to have an attorney draft the transactional financing paperwork.

CLARIFICATION OF SEVERAL OTHER EXEMPT TRANSACTIONS OF PROPERTIES

- Assumptions of underlying conventional loans are not covered by either Act.

- Loans that are not sales or part of sales
- Sales and loans that pre-date the effective dates are not covered by the Acts, (though current refinances or resales of those might be)
- Use of any possession-transferring or equity-transferring instrument that is absolute and without post-transfer debt, such as a deed or a transfer by gift or devise.
- Foreign transactions (foreign property);
- Private use of licensed private mortgage broker: The one safe harbor for those who want a general “safe pass” in the deal that meets both SAFE and DFA rules or for those who are bumping directly into the SAFE/DFA regulations or for those who have used up their “3 transactional freebies,”. Associating the MLO – this seems to bless the deal entirely.

FOCUS: ABILITY-TO-PAY DUE DILIGENCE:

As was noted above, for either conventional, VA and GSE loans or for qualifying under seller-carries where the rules require an MLO, the borrowers “ability to pay” is a significant part of the required loan or transactional due-diligence. Moreover, whether or not the rules make an ability to repay analyses mandatory, it is the correct practice to do so in every seller-carry as a matter of appropriate practice. ***It must be remembered that compliance with the bare rules of the CFPB, but engineering a bad deal for ones customer of client can still result in professional or licensure claims.*** **The borrower qualification in underwriting for seller carries is as noted above LESS onerous than for the traditional third-party mortgage lending under the QM. Here is the what is required for third-party lending (less documentation and verification for seller-carries).**

For traditional third-party mortgage loans:

- These rules took effect January 10, 2014
- The rules require mortgage lenders and, where applicable in seller-carries, either the seller or the MLO to verify a borrower's "ability to repay" the debt with substantive documentation. Lenders (and seller-carries where examining the ability to repay is required) must consider and confirm the following eight factors in assessing the borrower's ability to repay:

  > (1) Current income or assets;
  > (2) Current employment status;
  > (3) Credit history;
  > (4) The monthly payment for the mortgage;
  > (5) The monthly payments on any other loans associated with the property;
  > (6) The monthly payment for other mortgage-related obligations (e.g., insurance, PMI, property taxes, HOA, etc.);

> (7) Other debt obligations (car loans, student loans, credit card payments, etc.); and
> (8) The net monthly debt-to-income ratio the borrower will have (PITI and the above other recurrent debts).

- MLO/LMB FEES: There are fee limits which probably will apply to MLO or Licensed Mortgage Broker ("LMB") charges in either scenario, traditional loans or seller-carries (though it is doubtful that seller-carries should bear these kind of fees, since no money is being generated and the MLO due-diligence and liability is substantially less).

- THE QM STANDARDS: Though these underwriting standards are **NOT APPLICABLE to seller-carries,** they can be used as a "the Gold Standard" if the seller wishes only to extend "gilt-edged" loan to the borrower. The conventional rules applicable to the new QM mortgages limit any points and fees payable to loan brokers (not banks) to 3 percent of the loan amount, and limit the borrower's mortgage payments to 43% of the borrower's income. These rules may restrict conventional mortgage lending and therefore make home ownership more difficult on third-party loans, making the arguments for seller-carried ones all the stronger. For seller-carries, these limits do not apply, but exceeding them risks other claims, such as HOEPA (see above) issues or UDAAP claims (see below).

- DOWN PAYMENTS: There is no "minimum down payment" required of seller-carries. As to other loans, such as conventionals, the debate in Washington is continuing as to the amount of federally required minimum down payments. Other regulators (including the Federal Reserve, FDIC, HUD, USDA, VA, FHFA, etc.) may issue rules later establishing minimum requirements for down payments on traditional third-party home mortgages. Proposed down payment requirements have ranged from as low as 5% to as high as 30% (the later was briefly vetted in the summer of 2013 and promptly shouted down—likely for good). FHA remains at 3.5% and its other standards (ability to repay formulas) seem to remain outside of the rigid QM, but now with vastly increased PMI premiums. Seller-carries have no such down payments minimums, but a strong down is important to get the borrower's "skin in the game" sufficiently to encourage loyalty to payment and to assure that there is enough for commissions, closing costs, pro-rations and income taxes, with a little left for the seller, at least.

DUE-ON-SALE CLAUSES:

GENERALLY: Many properties have an underlying encumbrance which purports to restrict al or certain kinds of transfers. Arizona and California law

had long histories conceptually AGAINST the restrictions against transfer that the so-called due-on-sale clauses represented. After the Wellencamp and Dawn Investment California cases in 1978 and 1982, respectively, effectively prohibited lenders in those states (and had great influence in other states like Arizona) from arbitrarily enforcing these clauses, two legal developments came about. One was the passage by the Federal Home Loan Bank Board (followed by other federal regulatory agencies) of a rule which validated the clauses in debts issued by federally-chartered savings and loans (and later followed by the U.S. Comptroller of the Currency for federally-chartered banks), later validated by Fidelity Federal Saving and Loan v. de la Cuesta case of 1982 to overrule California law and some Arizona statutes which appeared not to permit due-on-sale enforcement on the basis that a federal rule "pre-empted" state law under the federal supremacy clause of the U.S. Constitution and other rational The other was the passage of the federal Garn-St. Germaine Act in 1982 which upheld certain enforcements of the due-on-sale clause for state-chartered banks and thrifts, which contended again, that it pre-empted state law to the contrary. The Garn Act excluded some transactions (prohibited restriction of them) that would thus be allowed under the California and Arizona law against restrictions: (1) the creation of a subordinate lien (2) transfers by death of a joint tenant (3) grant of a leasehold of no more than 3 years (4) transfers to certain relatives; (5) transfers to an inter vivos trust in which the borrower remains the occupant of the property. Arizona and California restrictions against restraints of alienation and contract penalties have not been repealed.

There have been in the past and are still some mortgages which had or have no due-on-sale clauses. The most common examples were and in some cases still are FHA and federal VA mortgages. On December 1, 1986, FHA began requiring credit checks before they would approve assumptions on the old 203b-types and generally thereafter. Starting February 29, 1988, new VA mortgages were not assumable unless the VA approved the new borrower and that borrower assumes the debt. In most cases, the Vet needs to make a "hardship application" to VA showing why the home needs to be liquidated and why the loan should stay intact and not be called. VA is often very liberal on this, as its purpose is to serve the Vet, but a "hardship waiver" needs to be applied for in writing showing a genuine hardship for the Vet to do it. On December 15, 1989, FHA put a number of strict assumption-and-subject-to-related rules into place. Generally, it will permit secondary carry-backs but requires the new buyer to qualify for and assume the first mortgage.

THE ETHICS OF A "WRAP"

The DREs of 70% of the states, including California and Arizona, have held that it is not unethical or a violation of licensure rules to "wrap" an underlying loan without lender consent (except FHAs). Instead they have held that it is unethical and a violation of licensure law for the real estate broker to FAIL TO DISCLOSE IN ADVANCE THE RISKS AND LIABILITIES OF THIS

IN WRITING TO THE PARTIES. Fraud claims by banks have routinely failed, the Courts holding that the remedy for a breach of a contract is foreclosure. This is not so where an affirmative misrepresentation has been made to a federally-insured lender. That is considered by the United States Code as an "unsworn perjury" and is punishable as a crime. Example: Wrapping a HAMP modification where the eligibility for this federal hardship benefit was tied to the original borrower's hardship and conditioned by his or her staying in the home.

MANDATORY LICENSURE DUTY TO DISCLOSE:

Under all real estate licensure laws of every state (and all licenses generally associated with finance), the licensee is required to disclose in writing UPFRONT to the seller and buyer "any and all matters which may tend to affect the consideration to be paid or accepted and the decision to engage in the transaction." That means the licensee must develop a Notice and Disclosure form for use in seller-carry transactions that identifies he above laws, identifies the risks and liabilities attendant in seller-carry finance, the risks of due-n-sale clauses in "wraps," challenges of insurance coverage in seller-carries and other risks. 99% of all brokerage paperwork out there currently does not do this. GET A LAWYER TO DRAFT COMPLYING PAPERWORK, NOW. YOUR LICENSE AND THAT OF ALL TRANSACTION PARTICIPANTS DEPENDS ON IT. The licensee also has the duty not to misquote the law or place parties into unenforceable or unlawful transactions that would include ones that violate state or federal law. In the present case, ones that violate the DFA or the CFPB.

TAX MATTERS:

If the plan is for an selling entity or individual to go deeply into offering seller-carries to consumers on residential property owned by it, him or her—beyond 3 deals a year—they will be a "dealer" and might even consider putting an MLO (or state equivalent as per state law) on staff. It is noteworthy to mention that "dealers" get entirely different tax treatments on gains from sales and in booking installment sales and a dealer program needs to be carefully vetted by a lawyer and CPA before offering it. Dealers will usually need TIL statements, full HUD-1s, additional disclosures and will normally receive ordinary income (not capital gains) tax treatment on profits and may even, if they are large enough not be able to qualify for installment treatment on gains.

TRUTH IN ADVERTISING AND LENDING:

In seller-caries, one needs to comply with truth-in-advertising and truth-in-lending laws when advertising. For instance, the law is that is financing terms are mentioned at all, all financing terms must be accurately and fully disclosed. Example: "*seller will carry paper at 4%!*" is inadequate. If a financing term is mentioned at all, then they all must be, i.e. "*seller will consider carrying contract on approved credit at not less than 10% down, loan balance bearing 4% per annum simple interest until paid, monthly payments of principal and interest equally amortized over 30 years, all due*

five years from the date of closing." Use of an attorney here is wise, but knowledge of those laws by the licensee is mandatory.

VERIFYING SELLER AND BUYER STATUS:

Forms need to be developed by all real estate licensees to determine before listing or even before pen is put to paper what kind of property is being offered, what kind of deal is being offered and who the seller is, how many properties the seller has sold in the last 12 months or in the coming 12 months and who the buyer is and for what purposes he is buying it, the terms seller insists upon (for MLO exemption qualification) and it must be DOCUMENTED. Most seller-finance sections of preliminary purchase agreements and seller-finance addendums out there currently do not do this. **GET A LAWYER TO DRAFT COMPLYING PAPERWORK, NOW. YOUR LICENSE AND THAT OF ALL TRANSACTION PARTICIPATS DEPENDS ON IT. CHECK OUT ONE FIRM THAT CAN ASSEMBLE A COMPLIANCE PACKAGE AND TRANSACTIONAL FORMS (INCLUDING THE SELLER CARRY DOCUMENTATION) SELLERS, BUYERS, BANKS, MORTGAGE AND REAL ESTATE BROKERAGES, TITLE AND ESCROW AT www.eckleylaw.com .**

MANDATORY DISCLOSURES IN GENERAL ADVERTISING OF ONE'S BUSINESS OR OF A PRODUCT

The Dodd-Frank Act the, the Consumer Financial Protection Bureau it created and the Federal Trade Commission have established jurisdiction over advertising methods, real estate transactions and the professional acts and practices of those in the field. The following are the new Rules in some select areas.

APPLICATION OF THE M.A.R.S RULE:

The abuses is snort sales, loan modifications and workouts are now so considered so abundant that the Feds had to drum up the complex new Mortgage Asset Relief rules ("M.A.R.S.") covering residential debt work-outs where failing to do it right and to give faulty disclosures can end of with regulatory fines of $11,000 a day…and even imprisonment. The FTC promulgated the MARS Rules which prohibit the making of misrepresentations in connection with foreclosure avoidance services by ANY person or entity, not just real estate licensees. (FILE NOTE: In July, 2011, M.A.R.S. was temporarily suspended as to real estate licensees, only, who are engaged in legitimate short sales—it was not suspended as to others—it is likely reinstated January 10, 2014 as all other CFPB rules and the cross-enforcement jurisdiction between the FTC and CFPB "go hard"). The fact is that MARS compliance is still a good idea for real estate licensees, since the

misrepresentations it prohibits are actually already prohibited by most licensure and general law, no matter whether MARS was there or even while it is suspended, as it is also a basic factual disclosure that has a foundation in other real estate and agency disclosure law. The MARS disclosure is triggered anytime one advertises “foreclosure prevention” services and includes HAMP, HAFA, 2MP, Hope for Homeowners and institutional programs as well as non-formal ones. Advertising can be written or oral and with a large audience or just two people talking over coffee. It can be implied by simply taking on the service. It requires disclosures at “first contact.” Obviously websites and e-mails would qualify. The notice should have AT LEAST the following disclosure:

“ SPECIAL NOTICE REQUIRED BY LAW FOR FORECLOSURE AVOIDANCE SERVICES:
XYZ REALTY COMPANY is not associated with the government and our service is not an official one approved by the government or your lender. Acceptance or denial of a foreclosure avoidance plan is still optional with the government and your lender. If as a seller you use our service and propose a foreclosure avoidance plan or a re-sale offer to your lender which is for less than the debt the lender is owed, your lender may reject the plan or the sale and it could thus fail. We do not collect advance fees for foreclosure avoidance plans and our fees or commissions for such plans are not payable to us unless and until the transaction closes. If you stop paying your mortgage, you could damage your credit rating, lose your home and suffer other legal liabilities. Our firm is restricted to real estate services and cannot render legal or tax advice to you. You should obtain that advice from an attorney, CPA or other licensed professionals.”

THE FTC MORTGAGE PRACTICES AND INFORMATION RULE (“MIP” OR “MIR”)

GENERALLY:
The Federal Trade Commission (FTC) has recently issued its Mortgage Acts and Practices Advertising Rule, alternatively, the “MIP” or “MIR”. The Rule imposes requirements on those that provide information about mortgage credit products to consumers –such as real estate licensee--by prohibiting misrepresentations during these communications and also imposing recordkeeping requirements. The Rule will impact real estate professionals that provide this information to consumers, such as giving a consumer a lenders rate sheet. The Rule took effect on August 19, 2011.

BACKGROUND:

The FTC published an Advance Notice of Proposed Rulemaking in 2009, and issued a proposed rule relating to unfair or deceptive acts and practices that may occur with regard to mortgage advertising in September 2010. The Rule

is intended to regulate unfair or deceptive practices in the advertising of mortgage products, and covers all entities involved in the process such as mortgage brokers, lenders, and home builders. The Rule will also cover real estate professionals when they are providing information about a mortgage credit product to a consumer, as outlined here.

THE RULE:

The Rule prohibits misrepresentations in a commercial communication about any term of a mortgage credit product. A commercial communication is broadly defined within the Rule, covering both oral and written statements designed to create an interest in purchasing goods or services, which in this case would be a mortgage credit product. A mortgage credit product is any form of credit that is offered to a consumer and secured by the consumers dwelling. The Rules coverage will include information about all mortgage terms and the Rule contains an extensive list of possible mortgage terms, including interest rates, products sold in conjunction with a mortgage such as credit insurance, amount of taxes, variability of interest rates, and prepayment penalties.

APPLICATION OF RULE TO REAL DESTATE PROFESSIONALS:

The Rule will apply when a real estate professional provides information about a specific mortgage product to a consumer. An example would be providing a consumer with rate sheets containing the current interest rate from a lender or providing a consumer with applications or other information for a specific mortgage product. All statements about the terms of a mortgage will be covered by the Rule, and will need to be retained for two years. In addition, the statements should have the disclaimer language discussed in this article in order to protect against later misrepresentation claims.

The FTC has stated in its comments that the Rule does not apply to purely informational communications not designed to cause the purchase of a good or service because these are not commercial communications. So, providing a consumer general information about market rates for different types of mortgages products will likely not be subject to the Rule because these are not related to a specific mortgage product. However, providing a consumer with the daily rates from a specific lender would trigger compliance with the rule. Similarly, going through the prequalification process with a consumer in order to determine the range of properties that a consumer may be eligible to purchase won’t require compliance with the Rule; however, providing a consumer with the documentation needed to apply for a preapproval from a lender for a mortgage loan will be covered by the Rule.

DISCLAIMER OR QUALIFYING STATEMENT:

In the preamble to the final Rule, the FTC notes that a disclaimer provided with a covered statement may correct a misleading impression, but only if it is sufficiently clear and prominent to convey the qualifying information effectively. Therefore, real estate professionals should always include a disclaimer when providing information to consumers about the terms of a mortgage credit product, as a properly crafted disclaimer can protect against later misrepresentation claims.

The disclaimer will need to be prominent, as the FTC notes in its comments that disclaimers in small type placed at the bottom of a document will not protect against misrepresentation claims. The disclaimer text should be separated from the other text in the covered statement, as language buried within the text may not be effective to protect against misrepresentation claims. Note that the disclaimer should be tailored to the type of information that you are providing to a client. If you are providing other services beyond transmitting basic mortgage information, you will need to tailor your disclaimer to cover those services.

RECORDKEEPING REQUIREMENTS:

If a real estate professional is subject to the Rule, the real estate professional is required to keep all covered commercial communications for 2 years from the date that the communication was made to the consumer. In order to comply with this section, the real estate professional should put all covered statements into writing and include the statements in each consumers file (paper or electronic) with the brokerage. This record retention system should become part of the brokerages overall record retention program.

A STATEMENT TYPE:

" SPECIAL NOTICE FOR MORTGAGEOR LOAN INFORMATION:

XYZ REALTY COMPANY may in the course of and incidental to its professional real estate service transmit to you basic mortgage or credit product information. This information is provided as a courtesy and by way of example, only, and not by way of recommending any mortgage or credit product information, not or an endorsement for any mortgage or credit provider service or product vendor, nor a guaranty that the final loan or credit product or service you receive will be the same as what is in the information. You are free to contact any lawful vendor for any mortgage or credit product you wish and shopping on your own for the best rates and terms and the loan or credit product that best fits your particular needs and budget is encouraged."

UDAAP LIABILITY

As noted, above, the CFPB has oversight of the real estate sales, mortgage brokerage and title insurance industry through its authority under the Dodd-Frank Act and the various agencies and laws that have been merged into the control of the CFPB, including RESPA, TILA and HUD. The CFPB has the power directly or through the agencies and laws it operates to penalize a firm or person for what it believes are ***"abusive practices."*** Title X (and by the CFPB's ability to enforce it through other agencies and forces) of the DFA says it is unlawful for anyone who provides a consumer financial product or service to engage in unfair, deceptive or abusive acts or practices ("UDAAP").

Title X defines an "unfair act or practice" as an act that : "A) causes or is likely to cause substantial injury to consumers, which is not reasonable avoidable by consumers and B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition."

An "abusive act or practice" is one that takes unreasonable advantage of: "A) a lack of understanding on the part of the consumer of the material risks, costs or conditions of the product or service; B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or serve; or C) the reasonable reliance by the consumer on a covered person to act in the interest of the consumer."

Example: RESPA says that it is illegal to split a settlement service fee when a service is not performed. Under *Freeman v Quicken Loans Inc. (No. 10-1042)*, the U.S. Supreme Court held that the charge for the settlement service must be divided between two more persons in order for there to be a violation. So, say a single settlement service provider charged a fee but did not provide an actual service or perhaps provided the service but marked up the fee, under *Freeman* there wouldn't be a RESPA violation. There could, however, be a UDAAP violation if the CFPB considered the provider's actions to be unfair or deceptive.

If the CFPB of FTC decides to file a lawsuit for a UDAAP violation, it has the authority to administer significant penalties which include:

- Rescission;
- Refund of money or the return of real property;
- Restitution;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages;
- Public notification regarding the violation;
- Limits on the activities or function of the individual or company; and
- Civil money penalties.

The civil money penalties that the CFPB or FTC can impose are substantial, including:

- $5,000 each day for a violation of the consumer protection statutes;
- $25,000 each day if the violation is reckless; and
- $1 million per day for any violation that is committed knowingly.

MANDATORY ARBITRATION CLAUSES PROHIBITED
WAIVER OF CONSUMER CLAIMS PROHIBITED

During the 1990's the commercial world discovered and fell in love with mandatory arbitration clauses. There were two reasons for this "love affair," one was sounder reasoning, the other was "darkly motivated." The sounder thinking was that civil litigation through the courts was becoming slow, contentious and expensive and Arbitration would sidestep that. The "darker motives" were to bar the usually weaker side from access to justice and to write the arbitration rules to favor the stronger side and, for the most part, create a private "Kangaroo Court" to predate upon the weaker side with impunity. Most arbitration clauses also had language in which the consumer waived consumer claims and rights they would otherwise have by law.

Both sides received flak. The "more reasonable" thinkers found that arbitration as not cheaper, shorter or less contentious. The "dark side" was lambasted by lobbies for consumer and user groups for "attempting to subvert justice." For the most part, the "dark side" won. Its lobbies even passed the Federal Arbitration Act which courts (lazy ones who hated full trial calendars) decided superseded state law in some states which prohibited or limited arbitrations. That long "trash and burn" by the dark side trail ended for consumers with DFA/CFPB.

In the Dodd-Frank Act, Congress diverged from the general policy of favoring arbitration as expressed in the Federal Arbitration Act. **In section 1414 of the Act, Congress expressly prohibited the inclusion of arbitration clauses in most residential mortgage loan contracts.** In section 921, Congress gave the Securities and Exchange Commission authority to prohibit or restrict use of such clauses for certain disputes, if it finds that doing so would be in the public interest and for the protection of investors. And then in section 1028, Congress expressly addressed the applicability of pre-dispute arbitration clauses "in connection with the offering or providing of consumer financial products or services." And prohibited it in any initial commitment agreements for a consumer product or service, like real estate,

mortgages, escrow services and probably home inspections.

See http://www.consumerfinance.gov/newsroom/prepared-remarks-of-director-richard-cordray-at-the-field-hearing-on-arbitration/

So here is what the new law says and it goes even further. If even indicates that a "waiver of claims" a consumer might otherwise have is also barred and unenforceable in such an agreement!

Mortgage Reform and Anti-Predatory Lending Act (TITLE 14 of DFA)

...
Section 1414
''(e) ARBITRATION.—

''(1) IN GENERAL.—No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.

''(2) POST-CONTROVERSY AGREEMENTS.—Subject to paragraph (3), paragraph (1) shall not be construed as limiting the right of the consumer and the creditor or any assignee to agree to arbitration or any other nonjudicial procedure as the method for resolving any controversy at any time after a dispute or claim under the transaction arises.

''(3) NO WAIVER OF STATUTORY CAUSE OF ACTION.—No provision of any residential mortgage loan or of any extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, and no other agreement between the consumer and the creditor relating to the residential mortgage loan or extension of credit referred to in paragraph (1), shall be applied or interpreted so as to bar a consumer from bringing an action in an appropriate district court of the United States, or any other court of competent jurisdiction, pursuant to section 130 or any other provision of law, for damages or other relief in connection with any alleged violation of this section, any other provision of this title, or any other Federal law.
Notably, the CFPB now encompasses all state and federal law and makes it all "FEDERAL LAW" as section (3), above incorporates.
This now bring into question every clause in every residential sale document in the U.S. which attempts to mandate Arbitration and/or waive or limit the damages and remedies available in consumer transactions to sellers, buyers, brokers, escrow or inspector duties or other consumer rights. Not only are they unenforceable, now THEY ACTUALLY VIOLATE CONSUMER LAW IN AND OF THEMSLEVES

BY EVEN BEING THERE IN THE FIRST PLACE! All Realtor organizations, especially, need to IMMEDIATELY review and revise their forms looking specifically for (1) mandatory arbitration clauses (void and prohibited from even being there) and (2) boilerplate blanket disclaimers of consumer rights or the sellers' or brokers' or inspectors' duties to comply with consumer law or the CFPB rules (void and unlawful).

Examination is made of the current new AAR seller-carry addendum.

Attached to this packet as "EXHIBIT B" is the AAR Seller-Finance Addendum. It contains numerous issues (covered in session). The checked potions on the attachment indicate troublesome portions form several points: (1) it requires the transaction "go hard" with checked terms that may, themselves, already violate the CFPB and HOEPA rules the moment they are checked and completed and signed; (2) it attempts to disclaim responsibility to generate a CFPB-compliant document at the time of a binding commitment by the parties (3) it gives no leadership at all on how to make lawful, enforceable transaction on the paperwork provided; (4) it attempts to push down to MLOs the duty to "put the deal together," which is "professional real estate activity" for which they are not licensed (and if they were, why should the real estate agent get any commission then?); and, for the greatest part (5) it attempts to waive consumer laws and consumer protections and (6) it is functionally a failure because it requires the seller and buyer ot go get an attorney and and MLO as part of theoffer and acceptance. How likely is that when the parties are hot to commit on a Saturday afternoon?

IT IS ELEMENTAL THAT IT IS THE *BUYER* WHO MUST FIRST BE CLASSIFIED. IF THIS IS NOT A "CONSUMER TRANSACTION," DETERMINED BY THE STATUS AND INTENTIONS OF THE BUYER, IT IS OUT OF THE CFPB. IF THE BUYER IS BUYING FOR PERSONAL FAMILY OR HOUSEHOLD USE AND/OR RESIDENTIAL OCCUPANCY, THEN THE SAFE ACT/CFBP TURNS TO THE SELLER TO DETERMINE IF THE SELLER IS SO "ASSUMED SOPHISTOCATED" BY THE NUMBER OF LIKE SALES HE HAS ENGAGED IN THAT THE SELLER NEEDS A MLO LICENSE HIMSELF OR THE TRANSACTION NEEDS THE ADDITIONAL PROTECTION OF AN LMO ENGAGED TO SHEPARD IT. NOT PROVIDED IN THIS PACKET IS THE REST OF THE PAPERWORK WHICH MUST ALSO BE COMPLIANT (THE SELLER'S CERTIFICATE, THE MLO ENGAGEMENT AGREEMENT, THE LOAN DOCUMENTATION, THE BROKER DISCLOSURES REQUIRED BY THE COMMISSIONER FOR SELLER-CARRIES, THE COMPLIANT ESCROW INSTRUCTIONS, ETC.) BUT THIS COMPLIANCE PACKAGE CAN BE EXCLUSIVELY OBTAINED

FROM education@eckleylaw.com.

AN "INSIDERS" SIDE-TAKE:

THERE IS A LOOPHOLE in the DFA/CFPB rules on QMs, reserves required for mortgage bankers, banks and portfolios to underwrite sub-QMs and the marketing of subprime equities on Wall Street. Here it is in a nutshell: If the underwriter/portfolio retains the mortgage and does not see participating interests of it into the secondary market or bundle it as a CMO and sell it on Wall Street, it does not have to have reserves or a QM rating. It can be subprime and, for the most part, the holder can issue it under any credit and appraisal terms the holder may wish, including easier qualifying terms, lower down payments, higher loan limits and more gentle appraisals and open to investor/borrowers on more creative terms. The cost for that: LIKLEY HIGHER INTEREST but, as has been seen in prior markets, hat has stopped very few residential homebuyers and home investors. Here is the key: The holder will have to be a heavily-self- capitalized entity such as a GE Capital or the like which portfolios all of the loans and never sells off the loans; instead it sells bonds in itself on the Street (and high yield ones at that because of the great returns it will make from the high-interest portfolio). Thus, it never sells the CMO and so it is outside of the QM underwriting standards, reserves, rating and mortgage-regulating regime. An "end run"! What a great opportunity for investors and likely a great hope for the marketplace, as the onerous QM chances every borrower to these new lending entities! **The future likely holds these "new subprimes"—a huge loophole in the DFA/CFPB—YOU HEARD IT HERE FIRST!**

WHAT TO ALL THESE CHANGES MEAN FOR INVESTORS?

SOME TIDBITS:

Assuming the above changes and trends, what are the "tips and traps" for investors or 2014 (and likely beyond)?

- There will likely be new, subprime, alternative finance for investment that does not fit the new, onerous federal guidelines and can assist in asset acquisition or disposition

- If the alternative financing spurs a value increase, then appreciation (where value is measured by FMV resale comps) is still a potential

objective; if the market flattens and tightens and especially with interest rates increases—something currently likely as the Feds stop supporting the market with zero-interest, Fed cash-flooding "quantitative easing"--then "income" is still the name of the game in the short and long run.

- If the "income market" in real estate is what one seeks, one approach is by making high-interest loans (and if one has enough money, by capitalizing a sub-prime lending entity); the other is to seek cap-rates on real estate holdings (commercial or residential or otherwise). "Buy income" has long been the rule in most investment, as net income is the only "real" return and appreciation based on prices that produce ever lower net income on investment is a fool's game leading only to bubbles which pop in everyone's face. The rental market, though a lot of replenishment is coming to it, still has intrinsic value if it is income-producing at higher rates. In that case, finding a good return with long-term tenants, one simply holds. Holding has two risks: (1) the rental market collapse due to overbuilding and rents plummet—this means less to those with long-term leases with solvent tenants; and/or (2) interest rates go dramatically up on depository monies, bonds, treasuries etc., reducing the value of the investment's income return in comparison to competing investments. Most of these market changes affecting income are longer-duration in coming forth—giving more time to adjust and adapt—than chasing all profits as profits only from a resale market in which more and more money is chasing less net cash return coming from holding the investment, itself, i.e. the "bubble market" which tends to explode overnight.

- Time to lock-in low borrowing rates; time to increase lending rates; unload fixed returns that only look good during times of low interest (surely stocks with P/E rations higher than 17—witness the recent market corrections and those sell-offs are mostly for P/E ratios higher than 25—hogs get slaughtered), as the low interest world is likely to disappear over the next several years (low-paying fixed long-term bonds, low-yielding long-term fixed portfolios, low-return annuities)

- Expect a continuing wash-out in local government borrowing. Time to reconsider munies and mini-likes (we are going to see more city and county insolvencies like Orange County and Detroit) with have access to Chapter 9 bankruptcies

- The percentage of homeowner-purchased and occupied homes is going backwards in the U.S.—it portends a continuing rental market up to the point of rental overbuilding or, in the event of undersupply, to the point where mortgage costs are less than rental costs

- Resale prices in some areas are topped out because they have reached

he prices where new-builds (often with in-built appraisal and finance) can compete by delivering the same or even a better product for the same, less or a little more.

- The deluxe residential market is moving sharply as high-end buyers determine that it is time to buy before the prices rise and super-jumbo mortgages have become available (and most of them are in such amounts and held in such a way that they are not regulated by QM)—this is an event best for sellers, buyers, loan and real estate brokers of these homes, but these assets are "personal notion" investments made for the most part for personal reasons having nothing to do with investment and, many times, made in spite of unsound investment purposes.

- The commercial office rental market is currently expanding as businesses recover and use the moment to take on the lower-rents still holding out after this crash in some areas; commercial retail space abandoned by the contraction is now filling as new retailers come to the market and old ones still solvent return; warehouse and storage markets geared to "just in time delivery" are flourishing and will continue to do so as warehousers seek low-tax, low-utility cost, low-wage environments near rails, airports and freeway hubs.

- Hard money is everywhere—consider lending it or borrowing it short-term or sound projects

- Low-yield rentals: exit; assets topped-out in resale value: sell

- Have cash and unsure where to invest or reinvest—hold for a while until it becomes clear where this "new economy" is going!

- If you are not making money where you are, consider investing elsewhere where money is to be made

- Watch consumer conduct—it is still twitchy and with consumer spending 70% of the "trickle down economy," when they don't spend, profits tied to asset appreciation is a risk and profits tied to "hold and collect" income is everything.

- Cater to foreign buyers and money—its everywhere as Persian and Arabic money estimated at $114 trillion flees the fundamentalist influences that it anticipates may very well dominate the Middle East (and it no longer trusts the stability of the EU). Asian money appears divided between the US and the new, highly-profitable Chinese moves into Africa and its own spheres of influence as it see US product consumption (and US sovereign debt) on the wane and seeks emerging new markets and more sound capital investments into its own expansion.

There is a lot more, but this is a good nutshell for 2014.

CONCLUSION

The above laws and rules are nothing less than a revolution in American banking, finance and economics. It will affect the US and the world. There is no doubt that it has affected and will radically continue to affect real estate markets, practices and investment. The verdict is still out as to whether these will be productive or destructive to this country and its people. Many call it an attempt to socialize America—nothing less than a political revolution. Some call it a "conspiracy" for the taking over of America by the giant financial powers, pressing the middle class down to the lower class and raising the upper classes to heights of wealth and power never before seen in the history of the world and certainly never seen in America (over 80% of the U.S. wealth from Wall Street over the last 10 years has gone to the 10% most wealthy people and families in America—this while the rest of America was losing their homes and jobs—and it still continues even during the so-called "recovery"). Others are calling it the "democratization" of money—curbing the Financial Predators and cheats who almost destroyed America and placing them under close watch. On January 10, 2014, the Great New Economic Experiment with the DFA and CFPB started. Obviously, the proof will be in the pudding.

========== 00 ==============

ECKLEY & ASSOCIATES, P.C.

DIAL TOLL-FREE 1-(800) 999-4LAW

ABOUT THE AUTHOR/SPEAKER:

J. ROBERT ECKLEY is a multi-state real estate, agency, construction and banking attorney, successful litigator, popular writer, educator and national speaker with an immense personal and professional involvement in forefront issues over the past four decades. He has established precedent at the Supreme Court and co-founded transactional laws, rules and forms that guide practitioners today. He has been named in the prestigious The Marquis's Honor List of "Who's Who in American Law." He was a real estate licensee for three decades, 5 years of which were with the Beverly Hills Board of Realtors®, 10 with the Phoenix, Scottsdale and Portland Associations of Realtors®, and is now an affiliate member of the North San Diego County Association of Realtors®. He was named to numerous Commissioner's Advisory Committees, He was a Director for 3 years of the Central Valley Chapter of Oregon Escrow Council, has been a 15-year Member of the American Society of Certified Fraud Examiners and is a 20-year member of the International Association of Financial Planners. He has received a host of leadership and instructor awards, is a CCIM Affiliate®, testified in Congress against the due-on-sale clauses in 1982, received a perfect auditor's score an keynote speaker and educator for the Las Vegas annual convention of the National Association of Realtors®, successfully fought against anti-consumer trends in state and federal in state and federal courts, fought against all and defended a half dozen state and nationally chartered banks and thrifts, and has

received leadership awards and honors from the late former California Governor and then U.S. President Ronald Reagan and former Arizona Governor and Secretary of U.S. Homeland Security Janet Napolitano, to cover just a few of the miles he has gone. In July, 2011, he was appointed by the Arizona Commissioner of Real Estate to serve a 2-year term on the state Commissioner's Advisory Committee and was renamed in 2013. He was recently named to the prestigious International Bar Association in London, England. He is a member of the Arizona Bar Association, the Oregon Bar Association, the U.S. District Court bars of various jurisdictions, Beverly Hills Bar Association and Los Angeles County Bar Association in California. He has put together, written up or advised on tens of thousands of transactions. He is a "been there, done that" type who is often as entertaining as he is practical and enlightening! See more at www.eckleylaw.com. If you want to be on his "Counselor's Corner" monthly hotline e-mail to education@eckleylaw.com or call toll-free 1-800-999-4LAW and ask for the help you need or to get on the hotline.

UNIFORM DISCLAIMER:

THE MATERIALS AND INFORMATION HEREIN IS FOR EDUCATIONAL USE ONLY AND NOT THE RENDERING OF DIRECT LEGAL, REAL ESTATE, ACCOUNTING OR FINANCIAL ADVICE. PROPER TECHNICAL ANSWERS VARY GREATLY FROM CASE TO CASE AND THUS REQUIRE SEPARATE AND DIRECT ANALYSES IN EVERY EVENT. ALL LEGAL, ACCOUNTING AND GENERAL ADVICE AND OPINIONS SHOULD THEREFORE IN EVERY CASE BE SOUGHT DIRCTLY FROM A COMPETENT, DULY-LICENSED PROFESSIONAL.

PERMISSION IS GRANTED BY THE AUTHOR TO ALL BROKERS AND EDUCATORS TO UTILIZE THIS ENTIRE PUBLICATION, WITH ACCREDITATION TO THE AUTHOR AND WITH THE ABOVE UNIFORM DISCLAIMER, IN THEIR CLASSES AND IN THEIR PRACTICES AND MAY CIRCULATE IT TO CLIENTS, CUSTOMERS AND COLLEAGUES

================================ 00000000 ======================================