

**SELLER-CARRIED FINANCING – WHAT REALTORS® NEED TO KNOW**  
**(PART ONE)**

By  
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***Introduction.*** *As an outgrowth of the collapse of the credit and housing markets in 2007-2008<sup>1</sup> a new regulatory regime arose. It was clear that the Federal Reserve, Secretary of the Treasury, Comptroller of Currency, Securities and Exchange Commission, and a host of others agencies, were incapable of doing what they were created to do, i.e. protect the American consumer and taxpayer. No, this was a job for an Uber-Agency.*

*So, thanks to the politicians, bureaucrats, and assorted lackeys, the [2010 Dodd-Frank Act](#) was born; an 848-page tome with nearly [14,000 pages of rules](#) that are still only 40% complete. And as an added house-warming gift from the Big Banks' Wall Street abuses, we now have the Consumer Finance Protection Bureau or "CFPB." To date, the "Bureau" has sought to oversee and regulate banks, non-banks, financial companies, credit unions, securities firms, payday lenders, mortgage servicers, foreclosure relief services, debt collectors, mortgages, mortgage bankers, mortgage brokers, credit cards, debit cards, student loans, and almost any other financial services provider that dares to move.*

*Caught in the regulatory crossfire is every American who owns one or more residential properties. Why? Because, it seems that in the eyes of our omniscient federal bureaucracy, if someone sells a one-to-four family home for residential purposes and carries back a note and trust deed for a portion of the purchase price, the future of our economy demands that regulations be in place to protect against the very same fraud and abuse that the Big Banks engaged in. Lost in the discussion is why are seller carry-back transactions even an issue? They not only didn't contribute to the worst financial crisis since the Great Depression, they weren't on anyone's regulatory radar when Dodd-Frank was drafted. So once again, the Little Guy becomes collateral damage in the government's effort to assure its own survival through the creation of even more bureaucracy – in short, to become Too Big To Fail.*

*For Realtors®, the de facto gatekeepers of our nation's housing industry, this means that they will become the first responders in any transaction they are handling where the seller will be carrying back "paper" – i.e. a note and trust deed [or in other areas of the country, a note and mortgage] secured by the home. With lenders raising the underwriting bar, and so many Americans just now emerging from a distressed housing event, the frequency of seller-carried financing is picking up. Accordingly, set out below is a discussion of the applicable state and federal laws that attempt to regulate this tiny, tiny sliver of commerce that failed to escape the regulatory net that was cast over the entire financial industry, with no regard for the unintended consequences.*

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<sup>1</sup> Many people mark these events - especially the collapse of the credit markets - as commencing in September, 2008, five years ago, when [Lehman Bros. filed for bankruptcy](#). But once the credit markets tightened up, housing was not far behind; banks and investment houses could no longer make risky loans that were passed off to gullible investors to buy. When it was learned that these billions of dollars of bundled loans were not Triple-A rated, as touted – but instead, were junk - that market dried up. Then the banks' only alternative was to either stop making these loans, or hold them in their own inventory. But since the banks didn't want to touch their own toxic sludge, the decision was easy – they just stopped making many home loans – except to the most creditworthy borrowers, i.e. the ones that don't need the money.

## OREGON LAW

Following mounting criticism of the lending industry, Oregon and many states revamped their mortgage lending laws. Today, [ORS Chapter 86A \(Mortgage Lending\)](#) governs the activities of mortgage bankers, mortgage brokers, and mortgage loan originators. For purposes of this article, mortgage bankers and mortgage brokers will not be discussed, as they do not bear directly on the issues at hand.<sup>2</sup>

**What is a “Mortgage Loan Originator”?** A “mortgage loan originator” or “MLO” is an individual who, for compensation or gain:

- Takes an application for a residential mortgage loan; or
- Offers or negotiates terms for a residential mortgage loan.

The term “Mortgage Loan Originator” does *not* include Oregon licensed real estate brokers, unless they receive compensation from a mortgage banker, mortgage broker, mortgage loan originator or lender, or one of their agents. [\[See, ORS 86A.200 et. seq.\]](#)

Under [12 USC Sec. 5102\(4\)\(D\) \(Definitions\)](#) (the “SAFE Act”), upon which ORS 86A.200, et. seq. is based, the term “real estate brokerage activity” means any activity that involves offering or providing real estate brokerage services to the public, including:

- Acting as a real estate agent or real estate broker for a buyer, seller, lessor, or lessee of real property;
- Bringing together parties interested in the sale, purchase, lease, rental, or exchange of real property;
- Negotiating, on behalf of any party, any portion of a contract relating to the sale, purchase, lease, rental, or exchange of real property (other than in connection with providing financing with respect to any such transaction);
- Engaging in any activity for which a person engaged in the activity is required to be registered or licensed as a real estate agent or real estate broker under any applicable law; and
- Offering to engage in any activity, or act in any capacity, described above.

Except as provided in the exemptions below, an individual may not engage in business as a mortgage loan originator in Oregon without first:

- Obtaining and maintaining a mortgage loan originator’s license; and
- Obtaining a unique identifier from the [Nationwide Mortgage Licensing System and Registry](#). [\[See, ORS 86A.203\(1\)\]](#)

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<sup>2</sup> Subject to certain exceptions, a **mortgage banker** means a person that for compensation, or in the expectation of compensation: (a) Either directly or indirectly makes, negotiates or offers to make or negotiate a mortgage banking loan or a mortgage loan; and (b) Services or sells a mortgage banking loan. Subject to certain exceptions, a **mortgage broker** means a person that: (a) Engages for the account of others or for the person’s own account, in the business of selling real estate paper (e.g. loans) whether as issuer, agent or principal to others; (b) Engages for the account of others or for the person’s own account, in the business of accepting funds from one or more persons for investment in real estate paper; or (c) For compensation, or in the expectation of compensation, either directly or indirectly makes, negotiates or offers to make or negotiate a mortgage loan. [See, ORS 86A.100 \(Definitions\)](#).

**Exemptions.**<sup>3</sup> There are several exemptions from the MLO licensing requirements found in [ORS 86A.203\(2\)](#) as amended by [Oregon House Bill 3482](#) in the 2013 Legislative Session. Of significance are the following exemptions; those in bold will be discussed in this article:

- 1) An individual who offers or negotiates terms of a residential mortgage loan with or on behalf of their spouse, child, sibling, parent, grandparent, grandchild or a relative in a similar relationship that is created by law, marriage or adoption;
- 2) **An individual who offers or negotiates terms of a residential mortgage loan that is secured by a dwelling that served as the individual’s residence;**
- 3) An attorney licensed or otherwise authorized to practice law in this state if the attorney (a) Negotiates the terms of a residential mortgage loan as an ancillary matter in the attorney’s representation of a client; and (b) Does not receive compensation from a mortgage banker, mortgage broker, mortgage loan originator or lender or an agent of the mortgage banker, mortgage broker, mortgage loan originator or lender;
- 4) **An individual who, as a seller during any 12-month period, offers or negotiates terms for not more than three (3) residential mortgage loans that are secured by a dwelling unit that did not serve as the individual’s residence.**

**Exemptions of Interest to Oregon Realtors®.** Let’s go through the two highlighted exemptions separately:

- **Property That Was The Seller’s Primary Residence.** This is self-explanatory. If the seller *ever* lived in the house as a residence, he or she is automatically exempted from the MLO licensing requirement. The property does not have to be the seller’s residence *today*; it could be a rental property or a second home. One claiming this exemption may not, at any one time, hold more than eight (8) residential mortgage loans without meeting the licensing requirements of a mortgage loan originator. However, as will be discussed later, just because the seller is exempted from the MLO licensing requirement does not necessarily mean he or she is exempted from other state or federal consumer protection laws.
- **Property That Was Not The Seller’s Primary Residence.** Under this exemption, an individual may conduct up to three (3) seller carry-back transactions over any rolling 12-month period and not be required to either obtain an MLO license, or use a licensed MLO. As above, if one holds more than eight (8) residential mortgage loans at any one time, he or she will have to secure an MLO license. Again, other state and federal consumer protection laws may still apply.

### **FEDERAL LAW**<sup>4</sup>

Of course, life would be far too simple if all we had to contend with was local regulation. But a bureaucrat is a bureaucrat, be they *employees for life* in the state or federal government. Telling others what is in their best interest is in their DNA - like OCD patients, they just can’t help themselves. That

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<sup>3</sup> Note: All of these exemptions are subject to the CFPB not implementing a guideline, rule, regulation or interpretive letter saying that one or more of them is inconsistent with requirements set forth in [12 U.S.C. 5101, et. seq. \(the SAFE Act\)](#).

<sup>4</sup>Of great assistance in preparing this article has been the National Association of Realtors® website [here](#) and this article, [“Impact of Loan Originator Final Rule of Seller Financing.”](#) Both the website and the article contain an abundance of useful information related to seller-carried financing.

being the case, on the issue of seller-carried financing, Realtors®, in Oregon and elsewhere, will have to deal with two levels of regulation.

On January 20, 2013, the CFPB released its final rule relating to loan originators. The bulk of it will take effect on January 10, 2014. The definition of an MLO under both state and federal law initially was so broad as to sweep up individuals selling their own residential property. How and why this happened in the first place is a mystery. The financial crisis was not caused by Mom and Pop sellers of their homes or rental property who carried back a note and trust deed. In fact, during the easy money days, *circa* 2005 – 2007, seller-carrybacks were nonexistent; anyone who could fog a mirror could get a loan – for 100% of the appraised value, *or more*. There was no need to ask a seller for financing assistance. So how is it that the bureaucrats and toadies in Washington and Salem, believe it is important to regulate this miniscule portion of the multi-trillion dollar real estate marketplace?<sup>5</sup> The answer? “*Since the SAFE Act didn’t expressly provide an exemption, the Oregon law cannot do so. So sorry!*”

Here are the Federal exclusions for seller carry-backs:

- **The 3-Property Exclusion.** This exclusion applies to natural persons as well as entities, such as corporations, and limited liability companies, etc. It permits one to carry back paper in not more than three transactions in any 12-month period. The seller may not have, in the course of their business, constructed the home on which the note and trust deed is taken. Here are the limitations on the terms of the carry-back financing:
  - It must be fully amortizing – no balloon payments or negative amortizations;
  - At the outset, the seller must make a good faith determination that the buyer has the ability to repay the “loan.” NAR’s publication states that CFPB’s Official Interpretations suggest earnings as evidenced by payroll or earnings statements, W-2s, income from other sources such as state or federal benefits or entitlements and rental income. The seller may rely on copies of tax returns.
  - The financing must have a fixed rate, or if adjustable, it can adjust no sooner than five years following the date of the loan. According to NAR, “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\*\*\*[and according to the CFPB’s Official Interpretations] an annual rate increase of up to 2 percentage points is reasonable. A lifetime cap of 6 percentage points, subject to the minimum floor or maximum ceiling up to any applicable usury limit, is reasonable. The “safe harbors” are not mandatory, but sellers would be wise to adopt them.”
- **The 1-Property Exemption.** This exemption only applies to natural persons, trusts and estates. It permits an owner to sell and take back a note and trust deed on one property within a 12-month period. As with the 3-property exemption, the seller may not have constructed the residence in the course of their business. Here are the financing limitations, which are more flexible than the 3-property exemption:
  - There can be no negative amortization – although balloon payments are permitted.

<sup>5</sup> A full discussion is beyond the scope of this article. The drafters of the SAFE Act apparently saw no need to specifically exclude certain transactions, believing that such exclusions could be carved out on a case-by-case basis at the state and federal levels. So NAR had to beg, plead, and cajole, before the CFPB would deign to create a limited safe harbor, and the OAR had to do the same via the Oregon legislative process.

- The interest rate may be fixed or adjustable, but if adjustable, the same limits described above for the 3-property exemption apply.
- ***Miscellaneous.***
  - Sellers, even if exempt under the federal rule, may not compensate their MLO based upon the terms of the loan [*e.g. getting a higher rate of interest or other seller-favorable terms.*]
  - The terms of any seller carry-back financing may not have a mandatory arbitration provision in the event of a dispute. This is not to say the parties may not agree to arbitrate disputes, but only after the dispute arises. The arrangement cannot be contained in the terms of the loan.
  - MLO activities are broad. They include such things as:
    - Taking a loan application;
    - Assisting a consumer in obtaining or applying to obtain a loan;
    - Offering or negotiating loan terms; and
    - Advertising the availability to provide such services.
  - According to the CFPB, the payment of real estate commissions for professional real estate activity does not constitute payment for MLO activity. However, it is imperative that Oregon licensees confine all their professional activity to pure brokerage services as they are commonly understood.<sup>6</sup> Any services, say for a lender selling an REO, that relate to financial services by the licensee [*e.g. taking a credit application*], should be avoided, as it will likely constitute providing MLO services without a license.
  - Note that if the property is being purchased by a buyer, say as a rental, and not as a primary residence, the MLO licensing restrictions do *not* apply. The regulations relate only to the sale of 1 to 4 family dwellings for use as a primary residence.

***[Part Two – How will these laws impact Realtors® and their clients?]***

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<sup>6</sup> See, [ORS 696.010\(12\)](#) for a listing of the activities constituting “professional real estate activity.”