A Walston Consulting Group

Special Report

Seller Financing and the Dodd-Frank Act

A Quick Breakdown for Real Estate Investors

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On January 10, 2014, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") went into full effect. And over a year later, many real estate investors and private lenders are as confused as ever. There's not a day that goes by that I don't get a phone call, email, or text with a question about how Dodd Franks affects us real estate investors.

So, here's the deal. The bill was drafted with the intent to prevent another significant financial crisis by creating new financial regulatory processes that enforce transparency and accountability while implementing rules for consumer protection. Sounds good, right?

Instead, it has created a great deal of confusion and has prompted numerous questions, particularly from sellers who are willing to finance the sale of their home, or private money lenders who wish to provide financing for homebuyers.

What does the Act mean for us? The following is a VERY brief summary regarding Dodd-Frank's direct impact on seller and private money financing of owner occupied residential property.

A Quick Background on Dodd-Frank

- Signed on July 2010 in response to the Wall Street and banking mortgage crisis
- Intent is to prevent lenders from making loans to borrowers without a reasonable and good faith determination of ability to pay
- Dodd-Frank is under the purview of the Consumer Financial Protection Bureau (CFPB)
- CFPB finalized the rules on January 10, 2013 with an effective date of January 10, 2014.
- The new rules apply to ALL loans and loan apps taken since that date

Here's what real estate investors (and private lenders) need to know about Dodd-Frank:

- The Dodd-Frank Act **does *not*** apply in any way to loans made on commercial property or vacant land.
- The Dodd-Frank Act **does *not*** apply to loans made on multi-family properties with five (5) or more units.
- The Dodd-Frank Act **does *not*** apply to loans made to non-owner occupied properties (such as loans made to investors or for vacation properties).
- The Dodd-Frank Act **does** apply to loans on a property to buyers who intend to occupy the property as their main residence.

A Brief Summary of the Dodd-Frank Act

The most relevant changes affecting lenders under provisions of the Act include:

- Requiring every lender to consider the borrower's ability to repay the loan
- Requiring that lenders consider at least 8 factors applied against reasonable underwriting guidelines
- Requiring lenders to wait at least 120 days of delinquency ***before*** beginning the foreclosure process
- Dodd-Frank combined with the SAFE Act in the various states, requires all owner finance transactions (except very specific exclusions) to be originated by a Residential Mortgage Loan Originator
- Prohibits builders from selling with owner financing
- Eliminates balloons and negative amortizing loans and requires fixed rates for 5 years with no prepayment penalties

- Sellers who sell with owner financing more than 3 times a year will become mortgage originators and must comply with Dodd-Frank

- No forced arbitration clause is allowed in the buyer's note

Now, even though **ALL** loans made to borrowers who intend to occupy a property as their primary residence are subject to the Dodd-Frank Act, the good news is that there are two special exclusions from the requirements:

1. The one property exclusion, in which a natural person, estate or trust provides seller financing for only one property in any 12-month period.

- Balloon payments will continue to be allowed;

- Ability to repay need not be considered or documented

- Promissory Note must be fixed for first 5 years, and then may adjust no more than 2 points per year with a cap at no more than 6 points above the original rate.

2. The three property exclusion in which any type of seller financing entity finances the sales of three or fewer properties in any 12-month period.

- No balloon payments will be allowed;

- Seller or lender must determine and show proof of borrower's ability to pay;

- Promissory note must be fixed for first 5 years, and then may adjust no more than 2 points per year with a cap at no more than 6 points above the original rate.

It's important to note that in order to qualify for either exclusion you must have owned the property which secures the loan. There are no exclusions from the Dodd-Frank rules and regulations for loans made on residential properties not owned by non-owner private lender. Accordingly, I strongly urge private lenders to deal only with non-owner occupants when making loans on properties which can be used as a residence.

Conclusion

Dodd-Frank and the Consumer Financial Protection Bureau is set up to protect consumers from predatory loan practices by institutions and other lenders. While owner financing is mentioned, it is not a big focus of the Act. Your focus should be on maintaining exemption or exclusion by knowing and adhering to the rules. If you're concerned, you may wish to hire a loan originator to process your deals in conjunction with your attorney.

If you would like to chat with me personally about how the Dodd-Frank Act is affecting your real estate business feel free to shoot me an email to bill@billonbusiness.net.

About the Author

Bill Walston is a full time real estate investor and mentor as well as a business and tax strategist who supports his clients in growing, promoting and building their real estate business. His passion is teaching creative business, investing, and tax strategies so his students make more, spend less, and live a tax deductible lifestyle.

He holds a Bachelor of Science degree in Accounting and Finance and a Master's Degree in Tax Law.

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Therefore, there is no guarantee that relying on this analysis will prevent governmental or civil actions against the private lender. If advice concerning legal or related matters is needed, the services of a fully qualified professional should be sought.