The unintended consequences of Dodd-Frank

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As of Jan. 21, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) began regulating all residential real estate transactions in the United States. This new act will have a negative effect on Florida's real estate economy and will alter what has traditionally been an accepted procedure: private seller financing.

Private seller financing, sometimes referred to as "purchase money financing" or "carry back financing" is where a private seller transfers title to property and accepts a mortgage for a substantial part of the sale price rather than receiving all cash on the sale. Private seller financing historically has been beneficial for buyers, sellers and Florida's economy.

For example, a couple who invested in a residential property and paid off the underlying mortgage decides that it would be a better return for their retirement if they sell the property and carry back a purchase money mortgage. By receiving payments from the buyer over the next few years, the seller would: a.) not receive all cash and the immediate tax impact, and b.) would have a higher return on their money than if they invest in Treasuries or certificates of deposits offered by banks.

In addition, buyers who cannot qualify for an institutional mortgages can nonetheless acquire title using seller financing.

Most home mortgages are amortized over 30 years, allowing for reasonable monthly payments. In a private seller financing scenario, a 30-year amortization is generally used with a balloon payment after three, five, or 10 years, for the private seller does not want to carry financing for 30 years. Even though Florida law provides adequate notification to a purchaser of a balloon mortgage and requires a notification to parties accepting financing with balloon mortgages, Dodd-Frank overrides Florida law and eliminates the ability of private sellers to utilize a balloon mortgage on the sale of their residences and severely impairs private seller financing.

Additionally, Dodd-Frank eliminates the ability of a small homebuilder to construct a home and sell that home to a third-party purchaser without the use of institutional financing. Dodd-Frank drives the private market to institutional financing, benefitting banks ("Wall Street") at the expense of the private seller ("Main Street"), exactly opposite of what it was intended to accomplish.

Some of Dodd-Frank's restrictions on private seller financing of residential property are:
- The seller cannot have constructed the home.
- The loan must be fully amortizing. No balloon payments are allowed.
- The seller must determine the buyer has reasonable ability to repay the loan.
- The loan must have a fixed interest rate for a minimum of five years.
- The loan must meet criteria identified by the Federal Reserve Board.

The small homebuilder has no ability to sell its homes using purchase money financing, and the couple who wanted to sell their property as a retirement investment cannot do so unless they want to hold the mortgage loan for an impractical period of time.

Dodd-Frank was touted as regulating Wall Street, but actually benefits institutional lenders at the expense of Main Street by making it illegal, or at least completely impractical, for private sellers to get a decent return on their investment. The penalties for a violation of Dodd-Frank are onerous and include treble damages. However, there are certain ways to avoid the negative affects of Dodd-Frank. Anyone intending to sell their property using traditional methods of seller financing should seek the advice of a qualified real estate attorney to avoid the serious penalties of the Dodd-Frank Act.

Kevin F. Jursinski is a Florida Bar board-certified real estate and business litigation attorney in Fort Myers.