HUD's "Final Rule" on the SAFE Act

A Community Owner's Perspective on its Impact on Retail Installment Contract and Lease-Option Seller-Financing

HUD's long-awaited "Final Rule" on the SAFE Act was officially released June 30, 2011. "Thank you" to MHI for following this development, and several other authors for their "take" on this important ruling. Here's one community owner's (CO) perspective on how the 150-page ruling affects retail installment contract (RIC) and lease-option sales of manufactured homes (MHs) in communities/LLCs.

Before the "Final Rule" was released, attorneys retained by MHI issued "preliminary comments" on what was likely to be included in the "Final Rule". An encouraging "clarification" was that SAFE Act licensing might not be required unless one is "in the business" of originating loans. Since Community Owner's primary business is managing communities, and since we only sell MHs and seller-finance sales to fill vacant rental home sites, some hoped HUD's "in the business" interpretation meant only full-time, dedicated mortgage originators and brokers would be required to hold SAFE Act licenses – and comply with the many provisions that licensure entails.

The "Final Rule" seemed to dash those "in the business" hopes for all but a few COs. HUD says one is "in the business" if they (or their firm) originate mortgage loans "for profit or gain", and do so on a "repetitious or habitualness" basis. What does that "clarification" mean to most of us Community Owner's who sell MHs and provide seller-financing?

It seems the first question we need to address, is "does the 'gain' HUD references apply to the sale of the MH or the financing?" Some Community Owner's are lucky enough to sell MHs at significant profits. Many of us, however, are satisfied to sell MHs at cost, to upgrade our communities and fill vacant sites (increasing cash flow and the value of the community). When we seller-finance a home, we know some buyers will default. And if the home is a new one, we know we're going to be reselling a used home – at a substantially depreciated price. So, if we add a little to the sales price of the new home to compensate for expected future defaults, are we selling the home for a "profit/gain"?

Likewise with the financing. If the CO borrows funds at 7%/year and uses those funds to seller-finance a MH at 10%/year, one might suggest he's making a profit on the financing. But when experience shows the routine cost of collection, and default-related costs of repossession, rehab, and resale runs 3%/year, is there then no profit/gain on the seller-financing offered by the CO?

The HUD statement on page 28 of the "Final Rule" may shed some light on this issue: "… a sales commission received by an individual in the manufactured home retail industry would likely meet the definition of "for

compensation or gain" if it is received or expected "in connection with" activities that constitute "offering or negotiating".

And how many seller-financed sales does it take to cross the threshold of "repetitious and habitualness"? HUD doesn't exactly shed a lot of light on that question when it says an individual or a firm crosses that threshold when its loan volume becomes repetitious or habitual (pages 7-8). Is there a minimum number of transactions per period that puts a lender into the category of habitual or repetitious? Again, HUD isn't much help when it says "HUD has no authority under the SAFE Act to establish a "de minimis" exemption that would shield individuals who do engage in the business of a loan originator from the SAFE Act's licensing requirements, who do so infrequently" (page 14). Similar information is contained in a statement on page 14, "HUD is unable to state how often an individual may undertake such transactions before the requisite habitualness is met".

Is there a legal definition of "habitualness" and "repetitious" that helps us interpret this "Final Rule"? Not really. Several law dictionaries, including Black's, define "habitual" in terms of "habitual offender" and "habitual drunkard" with such terms as customary, usual, recidivist, frequent or excessive use, and loss of willpower. Those same dictionaries have no legal definition for roots or derivatives of "repetitious" used in this context.

Is there one statement in the 150-page "Final Rule" that sums up HUD's position on SAFE Act licensing as it applies to our industry? Probably not, but this one on page 43 comes pretty close: "An individual engaging in the business of a loan originator with respect to a loan that is to be secured by a manufactured home, mobile home, recreational vehicle, house boat, or trailer that is to be used as a residence is subject to licensing under the SAFE Act."

What does the HUD "Final Rule" say about Lease-Option "financing"? Not much, but comments on pages 38 and 39 are noteworthy. In addition to language we've heard before, about mortgages, purchase money mortgages, installment contracts, and dwellings, HUD mentions "equivalent consensual security interests", saying that "… the fact that the seller holds title to the property until the contract has been paid in full is the practical equivalent of a lien for purposes of the SAFE Act and its purposes and is comparable to the status of a mortgage in a state that follows title theory under mortgage law." This seems to support surrendering the title to a MH at the point in a Lease-Option transaction where the Lessee exercises the option and the Lessor finances the sale, as mentioned by this author in previous articles.

A few words of caution: the Safe Act is federal banking legislation interpreted differently by different states. From time to time HUD and the newly-created Consumer Financial Protection Bureau (CFPB) issue "guidance" on various facets of the legislation which might affect opinions mentioned above.

Even if SAFE Act licenses are not required for Lease-Option transactions, other Federal regulations and state licenses may apply or be required. Consult an attorney familiar with the laws in the state(s) in which you operate.

Spencer Roane, Atlanta, GA, owns and manages four land lease communities in Georgia and Texas. His firm has sold manufactured homes on Lease-Option contracts in his communities over the past 20 years, involving more than 600 transactions. He serves on the Georgia Manufactured Housing Association board of directors and MHI's NCC and Disaster Housing Task Force. He holds both Mortgage Loan Originator and Mortgage Broker SAFE Act licenses. Other articles, Lease-Option documentation, and the HUD Final SAFE Act Rule are posted at www.LeaseOptionMHSales.com. Contact him at spencer@roane.com or (678) 428-0212.