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**JASON PROBST**  
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Greetings, Chairman Thompson, members of the committee.

Thank you for letting me speak today in support of HB2600.

I began working on this bill last session, after a group of leaders in Hutchinson raised concerns about abuses in our community regarding the sale of real property by contract for deed. At the time, Hutchinson had in place a rental registration program. The goal of the program was to ensure that tenants lived in safe conditions, and that rental properties met minimum standards on maintenance. However, homes sold on land contract fell into a gray area in which the homes weren't listed as rental properties, yet weren't owner occupied. Because Kansas law doesn't require any sort of recording of land contracts, there was no way to determine how many homes, or which homes, were being sold on contract.

This is not a new problem for Hutchinson. Several years ago, a particularly unscrupulous investor in our town exploited this land contract loophole. He bought homes on contract, rented them out or sold them on secondary contract. In some cases, he secured mortgages on the homes that he failed to pay, but still collected rent from his tenants - who were surprised to find themselves entangled in foreclosure proceedings. In 2010, the Kansas Securities Commissioner issued a Cease and Desist letter to this same individual, after it was discovered he was selling stock in his "Kansas real estate holding company" to unsuspecting investors. In all of these cases, there was nothing on public record to alert or protect lenders, investors, sellers, or buyers.

HB2600 very simply requires the seller to file an affidavit of equitable interest when real property is sold through a land contract or contract for deed. The goal is twofold - first to protect the buyer and the seller by making a publicly available statement about who has an interest in the property. The second is to protect banks and lenders - by likewise making it clear through public disclosure that there's more than one interested party in a property.

Kansas law currently allows buyers to do this on their own, but there is no requirement tied to a purchase or execution of a contract. It's generally a vulnerable population that purchases a home on contract. These families typically have limited financial resources, lack the credit for traditional financing, and have little ability to seek legal recourse. Yet they still possess the dream for home ownership that is nearly universal in American life. Land contracts serve as a pathway to

homeownership for some - but without even the slightest bit of oversight, it's also a pathway to exploitation.

This is not an issue that's unique to Hutchinson, or to Kansas – though the state's lack of any recording requirement makes abuses nearly impossible to quantify. Other states have encountered similar problems with the practice and have taken steps to improve the laws governing contracts. I've attached some information from KLRD that outlines steps other states have taken. Oklahoma, for example, treats all land contracts as mortgages, while Arizona law has a provision that grants buyers a substantial period of time to cure their interest in a property when a default occurs. I've also attached in my testimony a white paper outlining some of the contract for deed issues experienced by impoverished residents in South Texas, which resulted in significant reforms and protections in 1995 which were expanded upon in 2005.

Personally, I would like to see Kansas go considerably further than this bill and copy some of the best ideas from other states - such as equity protection for buyers, standardized contract language, and pre-purchase inspections. But after speaking with a number of people who touch this field, I thought it best to attempt a more measured step forward.

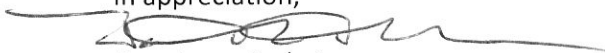
That being said - I'm sure it will come as a huge surprise for this committee to learn that not everyone agrees with me on this, and that this bill is far from perfect. You'll likely hear testimony from others with different points of view, and suggestions from others on how to improve the bill, should the committee choose to work it and advance it. I welcome any deliberation this committee might have on HB2600, including suggestions to augment implementation of its underlying goal, and I trust that improvements could be made through that thoughtful process.

In conclusion, I'd simply ask that the committee consider the void that currently exists in Kansas statute and how we might best address it. As the law currently stands, I could sell or buy a piece of real estate through a land contract scratched out hastily on a napkin and encounter less regulation and oversight that I'd find in buying or selling a vehicle. My hope is that we can begin to address this gap in statute by, at a minimum, requiring that there's a public notice of shared interest in a property. This simple measure would help protect vulnerable buyers from predatory sellers, protect sellers who have a legitimate claim to the property in the case of default, and protect lenders who currently have no way to know that there's multiple parties with claim to a deed.

I respectfully ask for your support on HB2600.

Thank you, and I'll stand for questions at the appropriate time.

In appreciation,



Rep. Jason Probst

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## **CONTRACTS FOR DEED: CHARTING RISKS AND NEW PATHS FOR ADVOCACY**

Despite the ongoing fallout from the foreclosure crisis, most families, rich and poor, still aspire to be homeowners.<sup>1</sup> In the informally settled communities of South Texas, where more than half the residents make less than \$1,600 a month, thousands of low-income families share in this quest.<sup>2</sup> Despite the extreme poverty in these communities, the homeownership rate is close to 80 percent--notably higher than the national rate of 65 percent.<sup>3</sup>

Families living in poverty buy homes in spite of the fact that they receive little or no benefit from government homeownership subsidies, such as the federal income tax deduction for mortgage interest and property taxes.<sup>4</sup> And they buy homes even when they do not qualify for traditional mortgage financing. In high-poverty communities we surveyed in Texas, 73 percent of homebuyers relied on seller financing; only 11 percent secured mortgages from lending institutions such as banks or credit unions (another 15 percent paid in full up front).<sup>5</sup>

While seller financing has opened up the doors to homeownership for thousands of families throughout the country, this form of financing can be very risky for buyers, exposing them to harsh conditions on the path to homeownership. One of the most common forms of seller financing is the contract for deed, described by one court as the "poor man's mortgage," \*38 where homebuyers can acquire title only after they have finished paying for the home.<sup>6</sup> Lawyers for the poor in several states have responded to the long history of sellers' abusive contract for deed practices by promoting comprehensive legislative reforms. These reforms offer buyers with contracts for deed some of the same protections available to buyers with traditional mortgages.<sup>7</sup>

In this article, we focus on contract for deed reforms adopted in Texas to address what was once a common financing method for low-income buyers attempting to purchase a home. The Texas reforms, now on the books for more than ten years, are some of the most sweeping contract for deed reforms in the country. Drawing from a recent study of homebuyers utilizing seller financing, we then present several problems that still remain for buyers in the wake of these reforms. Looking ahead, we draw on the Texas story and parallel reform efforts in other states to chart a course for future advocacy and policies that will provide a safer path to homeownership for our nation's most vulnerable homebuyers.

### **Contracts for Deed**

A contract for deed is a form of seller financing whereby the seller retains legal title until the homebuyer finishes making all the payments owed under the contract. These contracts are also referred to as installment contracts, bonds for deed, and executory contracts. The buyer promises to make regular monthly payments, usually with interest, toward the sales price over a set contract term. The down payments vary but can run in the thousands of dollars. The contract term may

run as long as thirty years, although more unscrupulous sellers may use a shorter contract term with a large balloon payment after a few years, making it almost impossible for the buyer to complete the purchase.<sup>8</sup> During the contract term, the buyer is typically responsible for property maintenance, property taxes, and home insurance.

Once the buyer finishes making the payments on the contract, the seller is supposed to execute a deed transferring the legal title to the buyer, and either the seller or buyer is responsible for recording the deed in the real property records. Sellers typically include a forfeiture clause, authorizing the seller to terminate the contract, regain possession, and retain all of the buyer's prior payments as liquidated damages when the buyer misses a payment or otherwise violates the terms of the contract.

### **\*39 Background**

Contracts for deed have a long and widespread history in the United States.<sup>9</sup> Today, the contracts are still actively used in residential sales by investors in many states, including Illinois, Minnesota, West Virginia, South Dakota, Ohio, South Carolina, Florida, New Mexico, and Texas.<sup>10</sup> They are most popular in places where there is a limited supply of affordable rental housing, an ample supply of affordable land or homes (typically in substandard condition), and a pool of interested buyers ineligible for bank financing.<sup>11</sup> In East St. Louis, Illinois, for example, the use of installment contracts has been widespread in neighborhoods where houses are older, in substandard condition, and mortgage credit is hard to access.<sup>12</sup>

But why have professional investors relied on contracts for deed and not simply rented homes to the poor?<sup>13</sup> Money, of course, is the answer. A homebuyer will agree to pay more per month than a renter because the homebuyer believes that the monthly payments will go toward the purchase of the home. A homebuyer will agree to put down a larger amount up front as a down payment as compared to a renter's security deposit. A homebuyer is likely to take better care of the property than a renter, and a seller is off the hook for repairs he would otherwise have to make as a landlord. The contract for deed seller can also require the homebuyer to pay the property taxes and insure the property. Meanwhile, the seller--who seldom ends up transferring the title to the property and completing the sale--can quickly and cheaply get rid of a buyer who misses a payment.

In the wake of the recent foreclosure crisis, as more homebuyers have been shut out of traditional bank financing, some urban areas have seen dramatic upticks in home sales using contracts for deed. In the Twin Cities metro area, for example, recorded contracts for deed have increased by 50 percent over the past five years.<sup>14</sup> Contracts for deed are also common today in informal housing settlements located near cities throughout the United States (cheap land subdivided into residential lots with buyers using manufactured homes, trailers, or self-built structures as their housing \*40 without proper infrastructure), as low-income families expand their geographic search for affordable homeownership opportunities.<sup>15</sup>

### **The Risks**

Contracts for deed and other forms of seller financing can offer important benefits to homebuyers in the form of low entry costs and open access.<sup>16</sup> However, these transactions lack many of the safeguards available to buyers in traditional third-party mortgages--with weaker legal protections and no bank, government agency, or title closing agent overseeing the transaction. As a result, homebuyers utilizing seller financing are prime targets for a host of abusive practices by unscrupulous sellers.<sup>17</sup> Absent state reforms, here is an abbreviated list of the central risks associated with contracts for deed:<sup>18</sup>

- *Losing Everything*: A major risk to buyers with contracts for deed stems from the use of forfeiture clauses and the seller's retention of title. With one missed payment, the seller can quickly terminate the contract and strip the homebuyer of all of the equity in the home.<sup>19</sup>
- *Bar on Assignments*: Because contracts for deed routinely bar assignments, a buyer who needs to move during the contract term is forced to choose between staying or terminating the contract and foregoing potentially tens of thousands of dollars in equity and the value of any improvements made to the property.
- *Substandard Property Conditions*: Contract for deed transactions provide investors with an easy way to circumvent repair obligations \*41 that ordinarily extend to landlords. An investor can place a contract for deed buyer in a substandard home without any obligations to repair the home-- leading one newspaper to recently label contracts for deed a "house of horror" for buyers.<sup>20</sup>
- *Title Defects*: Seller-financed home sales typically do not involve title examinations, which places buyers at risk of buying homes with a range of preexisting title defects, such as tax liens.<sup>21</sup>
- *Post-Purchase Liens*: Contract for deed buyers are particularly vulnerable to title defects arising after the transaction is initiated, given the seller's retention of the title. For example, in more than half the states, a contract for deed property is not protected from judgment liens issued by the seller's creditors during the contract term.<sup>22</sup>
- *Balloon Payments*: In some areas of the country, contract for deed sellers routinely require balloon payments within three to five years. If the buyer cannot come up with the cash or bank financing to make the balloon payment, he or she will lose the home.<sup>23</sup>

### The Texas Experience

In Texas, land investors began using contracts for deed in large volumes along the state's border with Mexico as early as the 1950s.<sup>24</sup> Working in unincorporated areas that became known as colonias, developers divided large tracts of land into individual lots with little or no infrastructure and then sold the lots via unrecorded contracts for deed to very poor families.<sup>25</sup> The lack of potable water and wastewater services, irregular platting, continual flooding, and unscrupulous sales tactics by many investors in the area contributed to a host of harsh living conditions.<sup>26</sup>

By the late 1980s, with the rapid proliferation of colonias, the land investors' abusive sales practices and plight of the residents had caught the attention of the Texas Legislature. Advocates for the poor pressed for regulation of contracts for deed as well as for reforms to address the substandard living conditions, unregulated subdivision practices, and lack of infrastructure within the colonias.<sup>27</sup>

## **\*42 The Reforms**

In 1995, on the heels of a legislative study describing the abusive use of contracts for deed, the Texas Legislature adopted its first, modest set of reforms to halt the victimization of buyers in the colonias, the Colonia Fair Land Sales Act.<sup>28</sup> Advocates for the poor continued to press for more comprehensive protections and, in 2001, the legislature responded with the adoption of a sweeping set of statewide reforms.<sup>29</sup> In 2005, the legislature adopted a final set of major reforms, providing contract for deed buyers with even greater protections and eliminating loopholes that investors had been using to work around the previous reforms.<sup>30</sup> A summary of the Texas reforms--seen as some of the most sweeping reforms in the country--are included below.

## **The Outcomes**

After the adoption of the Texas contract for deed reforms, concerns were raised that the new laws would shut down homeownership opportunities for the poor.<sup>31</sup> At least one real estate lawyer familiar with Texas titling practices declared that contracts for deed are "all but dead" as a result of the reforms.<sup>32</sup>

In 2011, the Texas Legislature indicated its interest in learning what impact these sweeping reforms have actually had on the use of contracts for deed in residential transactions.<sup>33</sup> In response, the state housing agency commissioned a study from the University of Texas School of Law and Lyndon B. Johnson School of Public Affairs.<sup>34</sup> The study, which we co-directed with our colleague Peter Ward, included surveys of more than 1,200 residents of colonias and other informal settlements in eight Texas counties.<sup>35</sup> \*43 The study provided a unique opportunity to examine not only the extent to which contracts for deed are still in use in Texas, but also (1) who is still using them; (2) how low-income buyers have fared under the new protections; and (3) what alternative transactions (if any) have supplanted the contract for deed.

We believe the following key findings from the study can help inform advocates' efforts in other parts of the country to address abusive seller-financing practices:

### ***Finding 1: Substantial Reduction in Investors' Use of Contracts for Deed***

One of the central findings of the Texas contracts for deed study is that the Texas reforms appear to have been quite successful in steering most land investors away from using contracts for deed. Whereas investors selling property in South Texas colonias prior to 1995 relied largely on unrecorded contracts for deed as the primary means for financing land sales, 73 to 83 percent of investor sales in the colonias after the 2003 legislative reforms utilized a deed and a deed of trust financing mechanism.<sup>36</sup> In contrast, the study found that consumer-to-consumer sales--transactions where low-income homeowners are selling their homes to new residents--are still relying heavily on contracts for deed, and many of these are unrecorded and out of compliance with state regulations.<sup>37</sup>

### ***Finding 2: Long-Term Homeownership Still Alive in Poor Communities***

Another central finding of the study is that, despite concerns to the contrary, the state legislative restrictions on contracts for deed have not shut down homeownership opportunities for the poor in Texas.<sup>38</sup> Of the homeowners we surveyed, more than half had purchased after 1996 (the year the reforms went into effect in the immediate border area), and nearly one-third had bought after 2003.<sup>39</sup> In subdivisions developed after 1996, 85 percent of the residents we surveyed were homebuyers and not renters.<sup>40</sup> The vast majority of these sales involved a deed and deed of trust with virtually no use

of recorded contracts for deed. Finally, we found that roughly 65 percent of the new residents we surveyed (those who \*44 had moved into their current homes after the reforms) were homebuyers as opposed to new renters with three-quarters of the buyers using seller financing.<sup>41</sup>

### *Finding 3: Alternative Forms of Abusive Sales Practices*

Not all homebuyers have experienced security after contracts for deed came under state regulation. As the Texas Legislature passed its protections and broadened and modified them over time, unscrupulous investors identified loopholes in these laws and developed a number of workarounds, perpetuating the predatory lending abuses that the legislature had sought to eliminate.

For example, in the early years after the Texas regulations, many sellers switched over to lease purchase options (aka rent-to-own contracts) to circumvent the reforms. These contracts are similar to contracts for deed in substance but were not expressly subject to the initial rounds of legislative reforms.<sup>42</sup> A subsequent legislative amendment resolved this issue by making lease purchase option contracts exceeding six months subject to most of the contract for deed restrictions.<sup>43</sup>

A second workaround that investors have used in Texas involves the misuse of deeds in lieu of foreclosure, or “security deeds.” In these transactions, the seller utilizes traditional seller financing with a note and deed of trust, but then requires the buyer to waive the right to foreclosure proceedings and give the deed back to the seller to hold as “security” in the event the buyer defaults on the note. Advocates have since persuaded the Texas Legislature to ban this workaround.<sup>44</sup>

Our study found that investors in Texas have found additional ways to exploit unwitting low-income buyers. By purchasing in a market that lacks adequate oversight and consumer protections, buyers utilizing seller financing still face a range of exploitative practices. These practices include the use of extremely high interest rates, aggressive filing of foreclosure actions for missed payments, and negative amortization schedules created by aggressive late fee charges rolled over into the principal. In our surveys, we also came across cases of developers having charged special assessments to close out the contract and provide the final deed.<sup>45</sup>

\*45 One of the most alarming findings from the study was a recent pattern of rapid and aggressive repossession by investors selling vacant lots in newly developed subdivisions in South Texas. The buyers in these transactions were some of the poorest residents we came across in our study.<sup>46</sup> In one new subdivision where the seller was utilizing deeds with deeds of trust as the financing mechanism, 45 percent of the lots sampled had been foreclosed upon at least once, and 44 percent of those foreclosures had occurred within a year of purchase.<sup>47</sup>

We found similar high rates of repossession in one Texas county where we found a small number of investors using recorded contracts for deed after the legislative reforms.<sup>48</sup> Close to one half of the contracts recorded between 1989 and 2011 had been canceled or foreclosed upon.<sup>49</sup> In short, many of today's homebuyers in seller-financed transactions are confronted with the same issues of volatility and loss that were rampant in the 1980s when Texas policymakers first began regulating these seller-financed transactions.

### **Looking Ahead: Charting Paths for Advocacy**

The overall takeaway is that the sweeping Texas legislative reforms did a lot but not enough to address abusive seller financing practices. As in other parts of the country, low-income homebuyers in Texas are still routinely taken advantage of by unscrupulous land investors. Gathering lessons learned from the Texas reforms and from advocates in other states, what can advocates for the poor do to tackle these abusive practices around the country?

In charting a path for future advocacy in this arena, advocates should consider the following areas:

### Legislative Reforms

A starting point for addressing the core risks with contracts for deed should be legislative reform. Here are some of the key legislative reforms that advocates for the poor have been working on in Texas and around the country:<sup>50</sup>

*\*46 • Elimination of Contracts for Deed:* Oklahoma's legislature was the first in the country to treat all contracts for deed as mortgages.<sup>51</sup> Texas advocates proposed legislation in 2013 that would automatically treat a recorded contract for deed as a warranty deed and deed of trust, but the bill died in committee.<sup>52</sup>

• *Equity Protections:* Short of eliminating all contracts for deed, there are other mechanisms for providing contract for deed buyers with greater equity protections. In some states, contracts for deed must be foreclosed upon in the same fashion as mortgages.<sup>53</sup> In Texas, if the buyer has made the first forty-eight months of payments or paid at least 40 percent of the contract, the seller can no longer enforce the forfeiture clause. Instead, the buyer has a right to the same non-judicial foreclosure procedures available in traditional mortgages, whereby a trustee sells the property at public auction, with the sales proceeds exceeding the debt going back to the buyer.<sup>54</sup>

• *Right to Convert:* In Texas, buyers have a right at any time to convert the contract for deed, without penalties, into a deed with deed of trust, subject to the same interest rates and payment terms contained in the contract.<sup>55</sup> Maryland gives buyers a right to convert the contract for deed into a deed and mortgage after paying 40 percent of the purchase price.<sup>56</sup>

• *Right to Cure:* Providing buyers with a right to cure is essential for protecting buyers who default under the contract. Arizona is one state that provides a longer cure period for buyers with greater investments in the property.<sup>57</sup>

• *Interest Rate Caps:* Minnesota law sets stringent caps on interest rates charged in lower dollar contract for deed transactions with the rate cap tied to the Federal National Mortgage Association posted yields on thirty-year mortgage commitments, plus four percentage points.<sup>58</sup>

*\*47 • Recording Requirements:* As part of comprehensive contract for deed reforms adopted in the 2010 Homeowner and Homebuyer Protection Act, North Carolina law requires both lease purchase contracts and contracts for deed to be recorded.<sup>59</sup>



- *Disclosures*: In Texas, sellers are required to provide the buyer with a number of pre-sale and post-sale disclosures, including a disclosure of property condition notice, a survey, a list of liens, and a disclosure of financing terms (similar to a Truth-in-Lending Act statement).<sup>60</sup> After the sale, the seller must provide a detailed annual accounting statement that includes a disclosure about any property taxes paid by seller.<sup>61</sup> All documents, including the contract and all disclosures, must be translated if negotiations are conducted in a language other than English.<sup>62</sup> This year, Minnesota also enacted detailed disclosure requirements.<sup>63</sup>
  
- *Ban Prepayment Penalties and Excessive Late Fees*: Texas bars sellers utilizing contracts for deed from charging a penalty for paying off a contract early and from charging excessive late fees.<sup>64</sup> North Carolina also bans pre-payment penalty fees except in the event that a property is encumbered by a deed of trust and the loan includes such a penalty.<sup>65</sup>
  
- *Require Seller to Hold Fee Simple Title*: In Texas, sellers utilizing contracts for deed are barred from selling property that is not free from prior liens and other encumbrances. During the term of the contract, the seller must continue to maintain the property free and clear of all liens, with a few exceptions.<sup>66</sup> North Carolina adopted similar reforms in 2010.<sup>67</sup>
  
- *Strict Sanctions for Noncompliance*: As a deterrent against violations, Texas law imposes harsh penalties on sellers who fail to follow the contract for deed laws. Penalties can run as high as \$250 a day \*48 and, in some cases, the buyer is entitled to unwind the transaction and obtain a refund of all payments made under the contract.<sup>68</sup>

### **Legal Assistance, Enforcement, and Community-Based Lending**

Even the most expansive protections for buyers will not bring about meaningful improvements unless buyers have somewhere to turn to when their rights under these laws are violated. There is a strong need for state attorneys general, appropriate federal and state regulatory agencies, and legal justice advocates to engage in more proactive enforcement of laws to protect low-income homebuyers who fall prey to unscrupulous sellers. Seller-financed transactions are largely under the radar screen of government officials, and thus, abuses occur frequently without fear of prosecution.

As part of enforcement efforts, advocacy is needed to ensure that the protections in federal banking legislation such as the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 and the Dodd-Frank Wall Street Reform and Consumer Protection Act extend to and are enforced against sellers utilizing contracts for deed, lease option contracts, and other forms of seller financing.<sup>69</sup> Support is also needed to allow for more community-based nonprofit lending institutions and community development corporations to assist low-income homebuyers with safer forms of home financing and avenues to homeownership. Creative, safer alternatives have been created in the payday lending field and should be explored as an alternative to predatory seller-financing in the low-income homebuyer market.<sup>70</sup>

Without more robust laws and enforcement, unsavory investors will continue to exploit the poor as they pursue the American dream of homeownership. We hope that the lessons from Texas's contract for deed reforms, including their

impact and shortcomings, will spawn successful reform and enforcement initiatives in other states. America has created a path to homeownership for middle and upper-income families “that is quite remarkable, while leaving the poor at the mercy of predatory lenders and rip-off artists.”<sup>71</sup> The time has come to ensure that the poor also have a path to homeownership that is well paved, sign-posted, and lit with sound safeguards and enforcement mechanisms.

Footnotes

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1 *See, e.g., FANNIE MAE NATIONAL HOUSING SURVEY--Q3 2012 DATA SUMMARY, t.q50 (June 6, 2013), <http://bit.ly/18J5zp7>.*

2 PETER M. WARD, HEATHER K. WAY & LUCILLE WOOD, THE CONTRACT FOR DEED PREVALENCE PROJECT, tbl.5.1 (Aug. 2012), <http://bit.ly/16f0tm8>. These findings were drawn from surveys of more than 1,200 randomly selected households in more than sixty-five unincorporated Texas communities in Hidalgo, Webb, El Paso, Cameron, Maverick, Starr, Guadalupe, and Hays counties.

3 *Id.* at tbl.5.14; U.S. Census Bureau, Annual Homeownership Rates for the United States and Regions: 1997-2012 (2013), <http://1.usa.gov/17Lr1eK>.

4 Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 ST. LOUIS U. PUB. L. REV. 113, 127 (2009).

5 WARD, WAY & WOOD, *supra* note 2, Appendix D.iv, <http://bit.ly/1dGIV59>.

6 *Ellis v. Butterfield*, 570 P.2d 1334, 1336 (Idaho 1977).

7 Contract for deed laws by state can be accessed at [www.contractfordeed.uslegal.com](http://www.contractfordeed.uslegal.com).

8 *See, e.g., Jeffrey Meitrodt, Contract for Deed Can Be House of Horror for Buyers*, MINNEAPOLIS STAR TRIB., Jan. 14, 2013, at 1A, <http://bit.ly/15QLfz4>.

9 Way, *supra* note 4, at 129.

10 *Id.* at 130-31; Prashant Gopal, Home sellers step up as last-resort lenders, CHICAGO DAILY HERALD, May 20, 2011, at L1; N.M. Ctr. on L. & Poverty, Legal Issues in New Mexico's Colonia Communities: A Report (July 2010), <http://bit.ly/1anrVli>; Meitrodt, *supra* note 8.

11 Way, *supra* note 4, at 129-30.

12 *Id.* at 130.

13 In contrast to professional investors, some contract for deed sellers are low-income owners who do not know of any other way to sell property. These transactions are just as risky to the buyers. However, the pecuniary benefits may not have been the primary reason for the seller's decision to use a contract for deed.

14 *See, e.g., Meitrodt, supra* note 8.

15 Way, *supra* note 4, at 131. Through the use of geographic information systems analysis, it has been estimated that roughly three to five million people live in informal settlements across the United States (*id.* at 131).

16 *Id.* at 133-34.

- 17 See, e.g., David S. Jones, 'Contract for Deed' Problems; Beware, Real Estate Center, Tex. A&M Univ. (Aug. 13, 2008), <http://bit.ly/14Dpy9h>; Tex. Low Income Hous. Info. Serv., *Home Buyer Scams Prey on Poor Immigrant Families*, HOUS. MATTERS NEWSL. (March 2005), <http://bit.ly/1gWrxrM>.
- 18 For a more detailed elaboration of these pitfalls. see Way, *supra* note 4, at 135-49.
- 19 Most state legislatures have not extended to contract for deed buyers the full range of statutory protections afforded a mortgagor in the foreclosure process--such as the right to cure, recoupment of equity upon sale, and right of redemption (Way, *supra* note 4, at 139-43). State courts have issued a range of judicial protections shielding contract for deed buyers from the harsh impacts of forfeiture clauses on the ground that the clauses shock the conscience of the court. However, the scope of these judicial protections are often unclear and applied in an ad hoc manner (see, e.g., *Grombone v. Krekel*, 754 P.2d 777, 778 (Colo. App. 1988) ("There are numerous Colorado decisions which have required that an installment land contract must be foreclosed as a mortgage. There are also many cases which have refused to treat such an agreement as a mortgage.")).
- 20 Meitrodt, *supra* note 8.
- 21 Way, *supra* note 4, at 136-38.
- 22 See 4-37 POWELL ON REAL PROPERTY § 37.21(1)(e)(ii) (2013).
- 23 Meitrodt, *supra* note 8 (finding that "not one of [the investor's] 160 buyers has been able to refinance their deals, which typically require six-figure balloon payments in three years").
- 24 Ray Thomas, *The Plight of Texas Colonias*, 62 TEX. B. J. 1045,1045 (1999); Tex. Sec'y of State, Colonias FAQ's (n.d.), <http://bit.ly/19BzqRg>.
- 25 Tex. Sec'y of State. *supra* note 24.
- 26 See Tex. Dep't Hous. & Cmty. Affairs, Background on the Colonias (n.d.), <http://bit.ly/1aYOQCS>.
- 27 Tex. Low Income Hous. Info. Serv., *supra* note 17.
- 28 S.B. 336, 74th Reg. Sess. (enrolled) (Tex. 1995) (amending TEXAS PROP. CODE, Subchapter D. and adding a new Subchapter E).
- 29 S.B. 198, 77th Reg. Sess. (enrolled) (Tex. 2001) (amending TEXAS PROP. CODE, Subchapters D and E).
- 30 H.B. 1823, 79th Reg. Sess. (enrolled) (Tex. 2005) (adding TEX. PROP. CODE §§ 5.0621, 5.081-5.085; amending §§ 5.062, 5.073, 5.077). For a concise summary of the Texas legislative reforms, see Judon Fambrough, Real Estate Center, 2005 Updates: Rules for Contracts for Deed, LEGAL ISSUES (Oct. 2005), <http://bit.ly/16fDk2p>.
- 31 Shelayne Clemmer, Texas's Attempt to Mitigate the Risks of Contracts for Deed--Too Much for Sellers--Too Little for Buyers, 38 ST. MARY'S L.J. 755, 768, 800 (2007).
- 32 David J. Willis, Owner Finance Homes. Owner Finance in Texas Residential Transactions (2010), <http://bit.ly/1anv3ub>.
- 33 Sunset Advisory Comm'n, Report to the 82nd Legislature 66 (Feb. 2011), <http://bit.ly/1anvzZh>.
- 34 Latin American Housing Network, Texas Housing Database, Texas Department of Housing and Community Affairs Project (Oct. 2012), [http:// bit.ly/17Vlazm](http://bit.ly/17Vlazm) (for complete study findings and databases).
- 35 The study was conducted with the support of the William Wayne Justice Center for Public Interest Law and the assistance of more than seventy-five students and faculty coordinated by the University of Texas at Austin School of Law pro bono program. Information about the pro bono program and the center can be found at <http://www.utexas.edu/law/centers/publicinterest/>.
- 36 WARD, WAY & WOOD, *supra* note 2, at VIII. Our study methodology yielded both "conservative" and "liberal" estimates of how many unrecorded contracts for deed and traditional warranty deeds continue to be in use by investors (*id.* at Chapter 4).

- 37 *Id.* at VII.
- 38 The residents surveyed in our study were quite poor: more than a third live on less than \$1,000 a month (*id.* at 5:3).
- 39 *Id.* at Appendix D.iii.
- 40 *Id.* at Appendix D.iv.
- 41 *Id.* at Excel Database.
- 42 In a typical lease purchase-option contract, the homebuyer pays a nonrefundable option fee up front and makes monthly payments under a lease for a set term. At the end of the lease term, if the buyer is able to secure financing (from a bank or the seller), the buyer is eligible to purchase the home and obtain title from the seller. Otherwise, the buyer forfeits all payments made under the contract.
- 43 TEX. PROP. CODE § 5.062(a)(2) (2012).
- 44 TEX. BUS. & COMMERCE CODE § 21.002 (2012).
- 45 WARD, WAY & WOOD, *supra* note 2, at 6:1-2. Interest rates ranging from 15 to 18 percent are typical; we found rates as high as 20 percent.
- 46 Of homebuyers who recently (2008-12) purchased from developers, 61 percent had a monthly household income of \$1,600 or less (*id.* at 5:21).
- 47 *Id.* at 5:15-16.
- 48 As we mention above, use of recorded contracts for deed by investors in Texas after the legislative reforms is quite rare. We chose to examine the transactions in this community in detail, in part, because they were so unique.
- 49 WARD, WAY & WOOD, *supra* note 2, at 3:13. Fewer than one fifth of these contracts had led to the buyer's acquisition of title. *Id.*
- 50 This list includes examples of reforms; we have not listed all the state reforms in each of these areas.
- 51 OKLA. STAT. ANN. tit. 16, § 11A (West 2013).
- 52 H.B. 2091, 83rd Reg. Sess. (Tex. 2013), <http://bit.ly/15TmkuC>.
- 53 *See, e.g.*, FLA. STAT. § 697.01 (2013).
- 54 TEX. PROP. CODE § 5.066 (2013). Similar to Texas, Ohio follows a “threshold approach” (20 percent contract price or five years of payments) before the buyer has the right to recoup any remaining equity in the property in the event of default (OHIO REV. CODE ANN. § 5313.07 (West 2013)).
- 55 TEX. PROP. CODE § 5.081 (2013).
- 56 MD. CODE ANN., REAL PROP. § 10-105(a) (LexisNexis 2013).
- 57 ARIZ. REV. STAT. ANN. § 33-742(D) (2013); *see also* N.D. CENT. CODE § 32-18-04 (2013).
- 58 MINN. STAT. § 47.20, Subds. 3 & 4a (2013). This rate may be increased by three points if the contract has a duration of ten years or less, but the rate may not exceed 15.75 percent. *Id.*
- 59 2010 Homeowner and Homebuyer Protection Act, S.B. 1015, N.C. Sess. Law 2010-164 (N.C. 2009) (adding Ch. 75, Art. 6 and Chs. 47G and 47H, N.C. GEN. STAT.); N.C. GEN. STAT. §§ 47G-2, 47H-2 (2013) (LexisNexis). Maryland and Texas laws also require sellers to record contracts for deed. MD. CODE ANN., REAL PROP. § 10-102(f) (LexisNexis 2013); TEX. PROP. CODE § 5.076 (2013).

- 60 TEX. PROP. CODE §§ 5.069-071(2013); *see also* IOWA CODE §§ 558.70-71 (2012).
- 61 TEX. PROP. CODE § 5.077 (2013).
- 62 TEX. PROP. CODE § 5.068 (2013).
- 63 2013 Minn. Laws, 88th Leg., 2013 Reg. Sess., Ch. 85, H.F. No. 729, Art. 6, § 8 (adding MINN. STAT. ANN. § 559.202), <http://bit.ly/1bDzBQ4>.
- 64 TEX. PROP. CODE § 5.073(a)(3), (a)(1)(2013).
- 65 N.C. GEN. STAT. § 47H-2(b)(13)(2013) (LexisNexis).
- 66 TEX. PROP. CODE § 5.085 (2013).
- 67 N.C. GEN. STAT. § 47H-6 (2012) (LexisNexis). For other protections pertaining to liens, see Way, *supra* note 4, at 169.
- 68 *See, e.g.*, TEX. PROP. CODE §§ 5.069(d), 5.070(b), 5.072(e), 5.077(c)-(d) (2013). For example, the failure to make an annual accounting statement can cause certain sellers to be liable for attorney fees and \$250 per day in liquidated damages up to the fair market value of the property. *Id.* § 5.077(d).
- 69 See generally Secure and Fair Enforcement for Mortgage Licensing Act, 12 U.S.C. § 5100, et seq., and Subtitles A, B, and C of the Mortgage Reform and Anti-Predatory Lending Act, Title XIV of Dodd-Frank, 15 U.S.C. § 1602, et seq.
- 70 Tex. Low Income Housing Info. Serv., *supra* note 17.
- 71 *Id.*

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## Jason Probst

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**From:** Robert Gallimore  
**Sent:** Monday, June 11, 2018 11:56 AM  
**To:** Jason Probst  
**Subject:** Land contract request

Rep. Probst:

The Director asked me to respond to the following request:

Local city government people are telling me they have a hard time doing anything about what they see to be abusive and predatory land contracts for homes because the practice is governed by state law. I'd like to get the statutes we have that pertain to how land contracts are handled.

“Land contract” usually means a contract that may also be referred to as a “contract for deed,” or “installment sales contract for real estate,” in which the owner of real estate agrees to sell to a buyer in return for periodic payments. The buyer typically receives possession of the real estate during the term of the contract, but legal title does not usually pass to the buyer until the contract price is paid in full.

The statutes governing Personal and Real Property are found in Chapter 58 of the KSAs. However, because land contracts involve contractual issues, Chapter 16, which governs contracts, is also applicable. In looking at the Kansas cases involving land contracts, it seems the main statute at issue in such cases is KSA 16-207, which sets the maximum rate of interest for contracts. The current version of the statute sets this rate at 15%.

I could find no statutory article specifically and comprehensively addressing land contracts. It is likely that, because the topic involves the intersection of real property and contracts law, situations involving land contracts can implicate statutes in both areas, and possibly others. For instance, the practices of a seller in marketing land contracts could invoke the protections of the Kansas Consumer Protection Act.

If you could provide any additional details regarding the situations in question, I may be able to more specifically identify other areas of statute that could be applicable.

Bob Gallimore

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## Jason Probst

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**From:** Robert Gallimore  
**Sent:** Friday, June 22, 2018 1:16 PM  
**To:** Jason Probst  
**Subject:** Further information regarding installment land contracts / contract for deed  
**Attachments:** CONTRACTS FOR DEED CHARTING RISKS AND NEW PATHS FOR ADVOCACY.pdf

Rep. Probst:

You requested additional information regarding installment land contracts (also known as contracts for deed). You asked if there are current registration requirements for land contracts in Kansas and any current recourse for a buyer who could lose the money they've already paid on a land contract if the seller exercises a land contract forfeiture clause. You also asked what other states have done with regard to regulating land contracts.

### *Kansas Land Contract Registration*

It appears there is no Kansas law *requiring* recording of installment land contracts. However, it appears an installment land contract *may* be recorded. (See KSA 79-3101: for purposes of the Mortgage Registration Act, "An executory contract for the sale of real estate, or a bond for a deed, the complete performance of which is deferred for a longer period than ninety days from its execution, under which the grantee or vendee is entitled to the possession of such real estate, by the terms of which the grantor holds the legal title as security for the unpaid purchase money, shall for the purpose of this act be treated as a mortgage of real property to secure the balance of the unpaid purchase price." See also Kansas Attorney General's Opinion 78-207 [mortgage registration tax must be paid on land contract before it is recorded].)

Because the legal title to property does not pass under a land contract until the final payment has been made, and because the owner does not need to institute foreclosure proceedings to exercise a land contract forfeiture clause, it appears there would be little incentive for the owner to record an installment land contract. However, real estate attorneys advise buyers to record a land contract (or a memorandum summarizing the contract) to place third parties on notice and help prevent, for example, a seller taking out a mortgage on property already under a land contract or even attempting to sell the same property through another land contract.

### *Recourse for Buyers' Equity Under Land Contracts in Kansas*

While there are no Kansas statutes addressing recourses for buyers who stand to lose equity in a property when a seller exercises a land contract forfeiture clause, there is some Kansas caselaw providing buyers with limited protection. While Kansas courts will generally uphold and enforce land contract forfeiture clauses, they also have applied equitable principles to provide buyers with a redemption period (similar to that provided in foreclosure) or to award buyers damages for the amount paid on the property above what the fair rental value for the property would have been during the buyers' time of possession. See *Mustard v. Sugar Valley Lakes*, 7 Kan. App. 2d 340 (1981). However, Kansas courts have also stated a buyer is not entitled to reimbursement for improvements to a property unless the value of the property is enhanced, and a buyer is not

entitled to equitable relief unless “monthly payments have been made with reasonable promptness and have been made for such a length of time that their aggregate amount constitutes the equivalent of a substantial payment of the purchase price.” *See Barnett v. Oliver*, 18 Kan. App. 2d 672 (1993); *Dallam v. Hedrick*, 16 Kan. App. 2d 258 (1990). In the *Dallam* case, the Kansas Court of Appeals found that payments representing 8% of the purchase price did not constitute “substantial payment” requiring equitable relief from forfeiture.

Practically, to avail themselves of the protections available in Kansas, buyers have to be aware of the importance of recording their installment land contract and, if the owner attempts to exercise a forfeiture clause in the contract without instituting a foreclosure proceeding, the buyer would need to obtain counsel to file an action to attempt to obtain equitable relief (and any available relief would likely be limited to the parameters described above).

### *Installment Land Contract Statutes in Other States*

I found a 2014 article, *Contracts for Deed: Charting Risks and New Paths for Advocacy*, that includes the following summary of legislative reforms related to installment land contracts that have been enacted in other states:

- *Elimination of Contracts for Deed:* Oklahoma's legislature was the first in the country to treat all contracts for deed as mortgages. Texas advocates proposed legislation in 2013 that would automatically treat a recorded contract for deed as a warranty deed and deed of trust, but the bill died in committee.
- *Equity Protections:* Short of eliminating all contracts for deed, there are other mechanisms for providing contract for deed buyers with greater equity protections. In some states, contracts for deed must be foreclosed upon in the same fashion as mortgages. In Texas, if the buyer has made the first forty-eight months of payments or paid at least 40 percent of the contract, the seller can no longer enforce the forfeiture clause. Instead, the buyer has a right to the same non-judicial foreclosure procedures available in traditional mortgages, whereby a trustee sells the property at public auction, with the sales proceeds exceeding the debt going back to the buyer.
- *Right to Convert:* In Texas, buyers have a right at any time to convert the contract for deed, without penalties, into a deed with deed of trust, subject to the same interest rates and payment terms contained in the contract. Maryland gives buyers a right to convert the contract for deed into a deed and mortgage after paying 40 percent of the purchase price.
- *Right to Cure:* Providing buyers with a right to cure is essential for protecting buyers who default under the contract. Arizona is one state that provides a longer cure period for buyers with greater investments in the property.
- *Interest Rate Caps:* Minnesota law sets stringent caps on interest rates charged in lower dollar contract for deed transactions with the rate cap tied to the Federal National Mortgage Association posted yields on thirty-year mortgage commitments, plus four percentage points.



- *Recording Requirements:* As part of comprehensive contract for deed reforms adopted in the 2010 Homeowner and Homebuyer Protection Act, North Carolina law requires both lease purchase contracts and contracts for deed to be recorded.
- *Disclosures:* In Texas, sellers are required to provide the buyer with a number of pre-sale and post-sale disclosures, including a disclosure of property condition notice, a survey, a list of liens, and a disclosure of financing terms (similar to a Truth-in-Lending Act statement). After the sale, the seller must provide a detailed annual accounting statement that includes a disclosure about any property taxes paid by seller. All documents, including the contract and all disclosures, must be translated if negotiations are conducted in a language other than English. This year, Minnesota also enacted detailed disclosure requirements.
- *Ban Prepayment Penalties and Excessive Late Fees:* Texas bars sellers utilizing contracts for deed from charging a penalty for paying off a contract early and from charging excessive late fees. North Carolina also bans pre-payment penalty fees except in the event that a property is encumbered by a deed of trust and the loan includes such a penalty.
- *Require Seller to Hold Fee Simple Title:* In Texas, sellers utilizing contracts for deed are barred from selling property that is not free from prior liens and other encumbrances. During the term of the contract, the seller must continue to maintain the property free and clear of all liens, with a few exceptions. North Carolina adopted similar reforms in 2010.
- *Strict Sanctions for Noncompliance:* As a deterrent against violations, Texas law imposes harsh penalties on sellers who fail to follow the contract for deed laws. Penalties can run as high as \$250 a day and, in some cases, the buyer is entitled to unwind the transaction and obtain a refund of all payments made under the contract.

I have attached the entire article, which also describes installment land contracts and the possible abuses of such contracts and discusses the experience of enacting legislative reforms in Texas.

This *New York Times* article from October 2017 describes some more recent state efforts regarding land contracts: <https://www.nytimes.com/2017/10/03/business/states-acting-to-protect-buyers-of-seller-financed-homes.html> .

I hope this information is helpful. Please let me know if you have any other questions or need any additional information regarding this topic. Please note that I will be out of the office next week but will return on July 2.

Thanks,

Bob Gallimore

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