

# Clearinghouse REVIEW

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# Contracts for Deed

CHARTING RISKS AND NEW PATHS FOR ADVOCACY

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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 despite receiving 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

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

<sup>2</sup>PETER M. WARD, HEATHER K. WAY & LUCILLE WOOD, THE CONTRACT FOR DEED PREVALENCE PROJECT tbl.5.1 (Oct. 2012), <http://bit.ly/16f0lm8>. These findings were drawn from surveys of more than 1,200 randomly selected households in more than 65 unincorporated Texas communities in Hidalgo, Webb, El Paso, Cameron, Maverick, Starr, Guadalupe, and Hays counties.

<sup>3</sup>*Id.* tbl.5.14; U.S. Census Bureau, Figure 5: Annual Homeownership Rates for the United States and Regions: 1968–2012 (2013), <http://1.usa.gov/17Lr1eK>.

<sup>4</sup>Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 SAINT LOUIS UNIVERSITY PUBLIC LAW REVIEW 113, 127 (2009).

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, exposed as they are 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,” 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>

Here we focus on contract-for-deed reforms adopted in Texas to deal with 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 10 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 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 advocacy and policies toward 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 con-

tract. 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 30 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 the 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.

## 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 fi-

<sup>5</sup>Ward, Way & Wood, *supra* note 2, app. D.iv, <http://bit.ly/1dGIV59>.

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

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

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

<sup>9</sup>Way, *supra* note 4, at 129.

<sup>10</sup>*Id.* at 130–31; Prashant Gopal, *Home Sellers Step Up as Last-Resort Lenders*, CHICAGO DAILY HERALD, May 20, 2011, at L1; New Mexico Center on Law and Poverty, *Legal Issues in New Mexico’s Colonia Communities: A Report* (July 2010), <http://bit.ly/1anrV1i>; Meitrodt, *supra* note 8.

nancing.<sup>11</sup> In East St. Louis, Illinois, for example, the use of installment contracts has been widespread in neighborhoods where houses are older, houses are 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 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 that 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 without proper infrastructure) as low-income families expand their geographic search for affordable homeownership opportunities.<sup>15</sup>

### The Risks

The low entry costs and open access of contracts for deed and other forms of seller financing can benefit homebuyers.<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>

<sup>11</sup>Way, *supra* note 4, at 129–30.

<sup>12</sup>*Id.* at 130.

<sup>13</sup>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.

<sup>14</sup>See, e.g., Meitrodt, *supra* note 8.

<sup>15</sup>Way, *supra* note 4, at 131. Roughly three to five million people are estimated, through geographic information systems analysis, to live in informal settlements across the United States (*id.* at 131).

<sup>16</sup>*Id.* at 133–34.

<sup>17</sup>See, e.g., David S. Jones, Real Estate Center, Texas A&M University, "Contract for Deed" Problems: Beware (Aug. 13, 2008), <http://bit.ly/14Dpy9h>; *Home Buyer Scams Prey on Poor Immigrant Families*, HOUSING MATTERS (Texas Low Income Housing Information Service, Austin, Tex.), March 2005, <http://bit.ly/19ZG9Ez>.

<sup>18</sup>For a more detailed elaboration of these pitfalls, see Way, *supra* note 4, at 135–49.

<sup>19</sup>Most state legislatures have not extended to contract-for-deed buyers the full range of statutory protections for a mortgagor in foreclosure—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 extended a range of judicial protections for contract-for-deed buyers against the harsh effects of forfeiture clauses on the ground that the clauses shock the conscience of the court. However, the scope of these judicial protections is often unclear, and the protections are often 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.")).

**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 forgoing potentially tens of thousands of dollars in equity and the value of any improvements on the property.

**Substandard Property Conditions.** Contract for deed transactions are an easy way for investors to circumvent repair obligations 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 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, and this places buyers at risk of buying homes with a range of preexisting title defects, such as tax liens.<sup>21</sup>

**Postpurchase Liens.** Because the seller retains the title, contract-for-deed buyers are particularly vulnerable to title defects arising after the transaction is initiated. 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, the buyer loses 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 deal with the substandard living conditions, unregulated subdivision practices, and lack of infrastructure within the colonias.<sup>27</sup>

## 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

<sup>20</sup>Meitrodt, *supra* note 8.

<sup>21</sup>Way, *supra* note 4, at 136–38.

<sup>22</sup>See 4 POWELL ON REAL PROPERTY § 37.21(1)(e)(ii) (2013).

<sup>23</sup>Meitrodt, *supra* note 8 (“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”).

<sup>24</sup>Ray Thomas, *The Plight of Texas Colonias*, 62 TEXAS BAR JOURNAL 1045, 1045 (1999); Texas Secretary of State, Colonias FAQs (n.d.), <http://bit.ly/19BzqRg>.

<sup>25</sup>Texas Secretary of State, *supra* note 24.

<sup>26</sup>See Texas Department of Housing and Community Affairs, Background on the Colonias (n.d.), <http://bit.ly/1aYOQCS>.

<sup>27</sup>*Home Buyer Scams Prey on Poor Immigrant Families*, *supra* note 17.

<sup>28</sup>S.B. 336, 74th Leg., Reg. Sess. (enrolled) (Tex. 1995) (amending TEXAS PROP. CODE subchapter D and adding a new subchapter E).

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>

### 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> And at least one real estate lawyer familiar with Texas titling practices declared that contracts for deed were “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, surveyed more than 1,200 residents of colonias and other informal settlements in eight Texas counties.<sup>35</sup> The study uniquely examined not only the extent to which contracts for deed were still in use in Texas but also (1) who was still using them, (2) how low-income buyers had fared under the new protections, and (3) what alternative transactions (if any) had supplanted the contract for deed.

We believe the following key findings from the study can help inform advocates’ fight in other parts of the country against 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 before 1995 relied largely on unrecorded contracts for deed as the primary means for financing land sales, 73 percent 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> By 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

<sup>29</sup>S.B. 198, 77th Leg., Reg. Sess. (enrolled) (Tex. 2001) (amending TEXAS PROP. CODE subchapters D and E).

<sup>30</sup>H.B. 1823, 79th Leg., 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 2005 Updates: *Rules Govern Contracts for Deed*, LEGAL ISSUES (Real Estate Center, College Station, Tex.), Oct. 2005, <http://bit.ly/16fDk2p>.

<sup>31</sup>Shelayne Clemmer, *Texas’s Attempt to Mitigate the Risks of Contracts for Deed—Too Much for Sellers—Too Little for Buyers*, 38 SAINT MARY’S LAW JOURNAL 755, 768, 800 (2007).

<sup>32</sup>David J. Willis, *Owner Finance Homes*, Owner Finance in Texas Residential Transactions (2010), <http://bit.ly/1anv3ub>.

<sup>33</sup>SUNSET ADVISORY COMMISSION, REPORT TO THE 82ND LEGISLATURE 66 (Feb. 2011), <http://bit.ly/1anvzZh>.

<sup>34</sup>For complete study findings and databases, see Latin American Housing Network, Texas Housing Database, Texas Department of Housing and Community Affairs Project (Oct. 2012), <http://bit.ly/17Vlazm>.

<sup>35</sup>The study was conducted with the support of the William Wayne Justice Center for Public Interest Law and the assistance of more than 75 students and faculty coordinated by the University of Texas at Austin School of Law pro bono program (see University of Texas at Austin School of Law, William Wayne Justice Center for Public Interest Law, <http://bit.ly/19X11QB>).

<sup>36</sup>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.* ch. 4).

<sup>37</sup>*Id.* at VII.

<sup>38</sup>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).

the immediate border area), and nearly one-third had bought after 2003.<sup>39</sup> We surveyed residents in subdivisions developed after 1996; there 85 percent of the residents were homebuyers and not renters.<sup>40</sup> Most of these sales involved a deed and deed of trust, with virtually no use of recorded contracts for deed. We found that roughly 65 percent of the new residents we surveyed (those who had moved into their current homes after the reforms) were homebuyers, not 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 felt secure after contracts for deed came under state regulation. As the Texas Legislature passed protections and broadened and modified them over time, unscrupulous investors identified loopholes 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 (also known as 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 to 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>

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 exploitative practices ranging from the use of extremely high interest rates and aggressive filing of foreclosure actions for missed payments to negative amortization schedules created by aggressive late-fee charges rolled over into the principal. We also came across cases of developers having charged special assessments to close out the contract and give the final deed.<sup>45</sup>

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

<sup>39</sup>*Id.* app. D.iii.

<sup>40</sup>*Id.* app. D.iv.

<sup>41</sup>*Id.*, Excel Database.

<sup>42</sup>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.

<sup>43</sup>TEX. PROP. CODE § 5.062(a)(2) (2012).

<sup>44</sup>TEX. BUS. & COM. CODE § 21.002 (2012).

<sup>45</sup>WARD, WAY & WOOD, *supra* note 2, at 6:1–2. Interest rates ranging from 15 percent to 18 percent are typical; we found rates as high as 20 percent.

<sup>46</sup>Of homebuyers who recently (2008–2012) purchased from developers, 61 percent had a monthly household income of \$1,600 or less (*id.* at 5:21).

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 a small number of investors used 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 cancelled or foreclosed.<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 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 combat 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. From the Texas reforms and from advocates in other states, what can advocates learn to tackle these abusive practices around the country?

For advocacy in this arena, advocates should consider the following areas:

**Legislative Reforms.** A starting point 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>

*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> This year Texas advocates proposed legislation 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 giving contract-for-deed buyers greater equity protections. In some states, contracts for deed must be foreclosed in the same fashion as mortgages.<sup>53</sup> In Texas, if the buyer has made the first 48 months of payments or paid at least 40 percent of the contract, the seller may no longer enforce the forfeiture clause. Instead the buyer has a right to the same nonjudicial 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 anytime 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.

<sup>47</sup>*Id.* at 5:15–16.

<sup>48</sup>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.

<sup>49</sup>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.*).

<sup>50</sup>This list includes examples of reforms; we do not list all the state reforms in each of these areas.

<sup>51</sup>OKLA. STAT. ANN. tit. 16, § 11A (West 2013).

<sup>52</sup>H.B. 2091, 83d Leg., Reg. Sess. (Tex. 2013), <http://bit.ly/15TmkuC>.

<sup>53</sup>See, e.g., FLA. STAT. § 697.01 (2013).

<sup>54</sup>TEX. PROP. CODE § 5.066 (2013). Ohio follows, as in Texas, 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)).

<sup>55</sup>TEX. PROP. CODE § 5.081 (2013).

<sup>56</sup>MD. CODE ANN., REAL PROP. § 10-105(a) (LexisNexis 2013).

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 30-year mortgage commitments, plus four percentage points.<sup>58</sup>

*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 give the buyer a number of presale and postsale disclosures, such as 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 give a detailed annual accounting statement with a disclosure about any property taxes paid by the 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 prepayment 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, 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 vio-

<sup>57</sup>ARIZ. REV. STAT. ANN § 33-742(D) (2013); see also N.D. CENT. CODE § 32-18-04 (2013).

<sup>58</sup>MINN. STAT. § 47.20, Subdivs. 3, 4a (2013). This rate may be increased by three points if the contract has a duration of 10 years or less, but the rate may not exceed 15.75 percent (*id.*).

<sup>59</sup>2010 Homeowner and Homebuyer Protection Act, S.B. 1015, N.C. SESS. LAW 2010-164 (N.C. 2009) (adding N.C. GEN. STAT. ch. 75, art. 6, and chapters 47G and 47H.); 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)).

<sup>60</sup>TEX. PROP. CODE §§ 5.069-071(2013); see also IOWA CODE §§ 558.70-71 (2012).

<sup>61</sup>TEX. PROP. CODE § 5.077 (2013).

<sup>62</sup>*Id.* § 5.068.

<sup>63</sup>2013 Minn. Laws, 88th Leg., 2013 Reg. Sess., ch. 85, H.F. No. 729, art. 6, § 8 (adding § 559.202), <http://bit.ly/1bDzBQ4>.

<sup>64</sup>TEX. PROP. CODE § 5.073(a)(3), (a)(1) (2013).

<sup>65</sup>N.C. GEN. STAT. § 47H-2(b)(13) (LexisNexis 2013).

<sup>66</sup>TEX. PROP. CODE § 5.085 (2013).

<sup>67</sup>N.C. GEN. STAT. § 47H-6 (LexisNexis 2012). For other protections pertaining to liens, see Way, *supra* note 4, at 169.

<sup>68</sup>See, e.g., TEX. PROP. CODE §§ 5.069(d), 5.070(b), 5.072(e), 5.077(c)-(d) (2013). E.g., 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)).

lated. 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' contract-for-deed reforms, 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.

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<sup>69</sup>See generally the 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 IX of Dodd-Frank, 15 U.S.C. §§ 1602 *et seq.*

<sup>70</sup>*Home Buyer Scams Prey on Poor Immigrant Families*, *supra* note 17.

<sup>71</sup>*Id.* at 6.



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