

## SENATE MEMORIAL 40 - TASK FORCE ON REAL ESTATE CONTRACTS

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### Report to the Legislative Interim Committee on Economic and Rural Development. Chair Senator Howie Morales

Mr. Chair and Members of the Committee:

The following is the report of the Task Force on Real Estate Contracts as called for pursuant to Senate Memorial 40 of the 2013 Regular Session of the New Mexico Legislature. The report is hereby submitted for your comments, questions and approval.

#### **INTRODUCTION & BACKGROUND – History of the issue and the problem**

Real estate contracts (RECs) are a ‘seller-financed’ means by which people buy and sell property in New Mexico. Essentially, they are a simpler vehicle than a traditional mortgage and the hallmark is that until all payments are made the seller continues to hold deed and title to the property. In these transactions, if the buyer breaches the contract by missing payment, the seller has the remedy of non-judicial foreclosure: buyer’s rights are converted to an at-will tenancy subject to the eviction process. These RECs have been used successfully for many years and we know that they are a valuable option for many buyers and sellers of property. The problems that have been identified arise almost exclusively when very low income purchasers use RECs to buy residential property and there is no effective oversight of the transaction. There are several negative results of this that harm both low income New Mexicans and the state itself.

Buyers who are not sophisticated about property transactions and who do not have the services of a professional broker or title and escrow agent fare the worst, especially when they purchase property from sellers who are either themselves less sophisticated or who hope to take unfair advantage. In such cases, the contracts often lack details which would seem obvious: a legal description of the property; the terms of the purchase itself (purchase price, interest rate and the course of payment); the condition of the property and its suitability for residential use; and the rights and responsibilities of the parties. Not only do some contracts fail to include these terms, but some of these agreements are not even made in writing. The result of this is that buyers may later find out the property they thought they were buying was not the property they moved onto, that the seller did not actually have title to the property “sold”, that the land was not suitable for residential use

and that there was a fundamental misunderstanding of the financial terms of the agreement. Buyers who miss just one payment after years of making them can lose their entire investment – even a house built on the property – with no court action required by the seller. Low income purchasers who later discover they were misled have little recourse to the courts, since they lack resources to hire lawyers and free legal services are severely lacking in New Mexico.

In unincorporated areas especially, less scrupulous sellers have used RECs to sell land that has become illegal subdivisions. They use these contracts to sell undeveloped and unregistered land, making empty promises about roads and utilities that are “on their way,” but never arrive. Such communities develop with no legal roads and no electrical, gas, sewer or water service. Residents can’t get permits to install septic tanks or wells, and roads and utilities can’t be brought in because there is no legal access to the parcel and no proper easements. Certainty as to who holds title to a parcel is necessary because only the legal owner can grant the easements necessary for infrastructure development. Children are forced to walk miles to reach the nearest school bus stop because school buses are prohibited from driving on undedicated roads. Emergency services vehicles cannot respond quickly to 911 calls because homes in these communities are not officially mapped. Government agencies that try to resolve these issues incur great expense attempting to determine the legitimacy of claims and interests involved since the properties were often never legally subdivided and no record of the sale of the properties was ever recorded.

Legislation was introduced in 2011 that was aimed at regulating RECs in a way that would address these issues. The various parties in interest could not reach a compromise that would both provide adequate protection and avoid the unintended consequence of making RECs an instrument that was no longer viable. Those parties – including members of the real estate industry and advocates for low income New Mexicans – met after that to try to better understand each other’s concerns. The parties made substantial progress, but could not reach final agreement on a bill to propose in 2013.

Senate Memorial 40, which passed unanimously in 2013, was intended to encourage the parties to work diligently together to reach agreement on key components of the REC issue in order to benefit New Mexicans. To that end, SM 40 called for the creation of a task force to study and report on potential solutions. This report is the result of the Task Force’s work. The task force has reached consensus on many of these issues and presents its recommendations here,

including a proposed bill that would afford protection to New Mexicans buying and selling residential real property under an REC.

## **RECOMMENDATIONS**

### **A. Contract Structure**

Here the task force was able to reach substantial agreement as to what a valid REC ought to include. This could be achieved through a bill that included all of the necessary provisions. There are some very good examples of such contracts that could serve as models that buyers and sellers could use. The task force also considered the possibility of including a kind of “model contract” as an appendix to a statute, the use of which could be considered a “safe harbor” for at least the form of the transaction. A valid REC would include the following:

#### **a. Disclosure of terms, description and conditions**

The names and addresses of the buyer and seller are required, as is the legal description of the property that is the subject of the REC, as determined by the county clerk’s records. The contract would specify the full purchase price, any down payment, the monthly payment required and the interest rate charged. The date by which the contract was expected to be completed would be specified, with language that informed the purchaser that such date was presumptive of on-time payments, which would be defined. Whether the property included road and utility easements would be disclosed. The contract must specify that the deed is to be deposited in escrow.

- Some task force members also believed that the seller’s disclosure should include whether the property is suitable and zoned for residential use and the availability of critical infrastructure including roads, water, sewer, and gas and electric services.

#### **b. Rights, responsibilities and remedies**

The contract would spell out in relatively simple terms for what each party is responsible and what happens when either of them fails to fulfill such obligation. This would include any late payment penalty,

the process a seller must take to remove a defaulting buyer and the reasons and process required of a buyer seeking to rescind the contract.

**c. Mandatory use of escrow services**

Under the new regulatory structure, RECs transactions subject to it would be required to utilize the services of a licensed escrow agent. This is intended to ensure that an impartial person is examining the legal propriety of the transaction, minimizing the risk to both parties. The deed would be delivered into escrow and the agent would examine required notices prior to default or rescission.

**d. Exemptions/Exceptions**

The mandatory contract provisions included here are intended to protect low income, less sophisticated purchasers of real property for residential use. Those transactions that do not fit that description would not be subject to the requirements, except for the recording requirement..

- Some task force members thought that transactions between family members should not be subject to most of the requirements of a new regulatory scheme, though such transactions should be recorded

**e. Equity Protection**

This is an issue on which the task force did not reach consensus, but which is important to note. The bill introduced in the 2011 session included a provision to provide some measure of protection to those buyers who have a sustained history of making payment and improving the property, but who then miss a payment and become subject to losing everything through the “non-judicial foreclosure” process described above. The provision was based on the statutes in other states and case law regarding ‘unjust enrichment.’ After making payments over a certain period of time, or percentage of the sale price, a buyer that defaults would have claim to the equity built up and, if improvements were made to the property, compensation for those.

Industry members of the task force and advocates for buyers were strongly divided on this, with industry arguing that the proposed process was so cumbersome and potentially unfair that very few sellers would opt for using RECs and therefore the low income buyer might be shut out of the market. While advocates for buyers did not agree with that position, the task force chose to set this issue aside at this time.

## **B. Recording Transactions**

In order for counties to fulfill their obligation to manage their land, they must have a record of transactions affecting the ownership of it. In many cases – especially in those involving low income buyers of residential property in unincorporated areas – the RECs are never recorded with county clerks. In some cases, buyers who attempted to record their REC with the county were not allowed to do so. While there is already a requirement that land sales are recorded, it would be wise to specifically include a mandatory recording provision in any proposed legislation in this area.

- Some task force members expressed concern that in certain cases sellers would not want to record a sale because they could be penalized for doing so. For example, a person buying property on a mortgage often is subject to a “due on sale” clause under which all money owed on the mortgage must be paid to the bank upon sale. If that person wanted to sell the property under an REC to an informed and willing buyer, recording the sale would mean that the mortgage holder could find out and “call the note”. Thus a transaction that both parties wanted would be thwarted.
- Some task force members also believe that RECs entered into in the past ought to be recorded now. This would aid counties in having a better ability to regulate land use, better enable infrastructure development and better ensure unclouded title.

## **C. Enforcement and Remedy**

One issue that the task force had substantial agreement on was the need for better enforcement of existing law as well as a provision that would enable aggrieved parties to have access to the courts, if needed.

- a. RECs are to be considered extensions of credit

As such, these transactions would be subject to consumer protection provisions that are enforceable by the Attorney General's office.

#### b. Violations of the requirements

Because low income people rarely have the funds to hire lawyers and free legal services are too scarce to rely upon, the rights provided in a new bill and in contract require a means to ensure they can be enforced. The private bar would be more likely to take such cases if they could be awarded fees for successfully representing low income clients. Such a provision should be incorporated into the proposed bill.

- Some task force members are of the opinion that if existing law was effectively enforced, no change in the law is needed.

#### D. Education

All agreed that a key component to addressing this problem in a way that benefits all concerned is education. Those who are buying and selling real property intended for residential use must understand their rights and responsibilities. Even if there is good legislation intended to provide clear direction to parties to REC transactions, it cannot be effective unless they are aware of it and there are resources available to assist them. A relatively small amount of state funding could go a long way

Such educational efforts could and should come from a variety of sources:

- Public sector - consumer protection bureaus or county recorder or planning and zoning department could produce and distribute educational materials.
- Private sector – real estate industry entities such as the Realtors Association of New Mexico (RANM), the New Mexico Land Title Association and others could produce and distribute educational materials.
- Not-for-profit sector – community, social services and advocacy organizations could likewise participate, building on the work they have done and the relationships they have cultivated.

## CONCLUSION

The Task Force recognizes that unregulated RECs can harm low income New Mexicans who are not educated about real property transactions. This has implications for New Mexico's development as well. This Task Force has studied the issue from all sides in an effort to ensure that RECs remain a viable option for real property buyers and sellers without the negative consequences that have been observed through the years. The Task Force makes these recommendations for legislative action to that end.

Respectfully Submitted,

Senate Memorial 40 Task Force on Real Estate Contracts

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