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FISCAL IMPACT REPORT

ORIGINAL DATE 02/15/11

SPONSOR Wirth LAST UPDATED _____ HB _____

SHORT TITLE Enact "Real Estate Installment Contract Act" SB 320

ANALYST Wilson

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY11 | FY12 | FY13 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|--------------|------|------------------|------|----------------------|-------------------------|------------------|
| Total | | NFI See Below | | | | |

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Administrative Office of the Courts (AOC)

Attorney General's Office (AGO)

Regulation & Licensing (RLD)

SUMMARY

Synopsis of Bill

Senate Bill 320 enacts the Real Estate Installment Contract Act (REICA). The bill provides the guidelines of the rights and obligations of both sellers and purchasers of residential real estate properties under a real estate contract not involving sale to immediate family members and properties with a sale price of less than \$200,000.

This bill describes the interests of each party during the term of the contract. A loan secured by a mortgage or deed of trust is not defined as a real estate installment contract. This means that SB 320 is only applicable when the seller extends the financing of the purchase for residential real estate. SB 320 considers that the transaction of the sale of real property using a real estate installment contract is an extension of credit. Therefore, this bill provides cost of credit disclosures that are already found in federal law-- namely the Truth in Lending Act.

The seller must disclose the condition of the property no less than seven days before the execution of the real estate installment contract. The seller must provide the buyer with a survey or plat of a survey, a detailed description of the available utility services available at the property, valuation and insurance coverage of the property. Furthermore, the seller is obligated to inform the buyer in writing what utilities are not available and whether permits are required and

what the process entails to install any non-existing utility services. Finally, the seller must provide the buyer with a copy of the real estate installment contract.

The required provisions of a real estate installment contract are:

- The buyer will acquire an interest in the subject real estate property in proportion to the amount of the principal upon the payment of 20% of the principal or the equivalent of 60 monthly payments whichever occurs first. In other words, the buyer of property under a real estate installment contract will be part owner of the subject real estate property once buyer passes the threshold of contribution towards the purchase of property.
- The contract must be in writing and contain all essential provisions. This is consistent with the Statute of Frauds which requires contracts involving real estate to be valid only if they are in writing.
- The contract shall contain all of the contact information of the parties.
- The contract shall contain provisions of the legal description, the purchase price, the amount of down payment, if any, the interest charged, the total amount of principal and interest to be paid under the contract, the amount of a late charge, if any, a statement as to the remedies available to the seller in the event of the buyer's default, and a notification that there is no penalty for pre-paying the principal amount at any time during the term of the contract. These provisions are consistent with the present federal law related to the proper disclosures of the cost of credit to consumers, namely the Truth in Lending Act.
- The contract shall contain a notice proximate to the buyer's signature a statement that the buyer has the right to cancel the contract for any reason within 14 days.

The seller is obligated to provide at the option of the purchaser four different documents in either the English or Spanish languages: (1) the contract itself; (2) the notice of cancellation form; (3) the accounting statements; and (4) the notices of default. All other documents must be provided by the seller to the buyer in the English Language.

SB 320 lists five different prohibitions and these are:

- To impose a late payment fee that exceeds 8% of the amount of the payment past due;
- To impose an interest rate that is in excess of five percentage points above the prime rate as published by the western district edition of the Wall Street Journal within seven days of the date of the contract.
- The buyer is prohibited from pledging his or her interest in the property as security to obtain a loan to place improvements on the property unless the buyer has already paid at least 20% of the principal amount or the equivalent of 60 monthly payments.
- To impose a prepayment penalty; or
- To forfeit an option fee or other option payment as a result of a late payment.

The buyer may cancel the purchase within 14 days of the execution of the contract for any reason and with no penalty. The seller is also obligated to provide the buyer with a notice of

cancellation form indicating by when and where the cancellation form must be sent in order for the buyer to effectuate the cancellation. The notice must also describe the consequences of the cancellation which includes the return of the executed contract and the refund and return of all monies paid under the contract.

Real property may be sold with a lien or encumbrance at the time of sale provided that such fact is disclosed. After the sale under a real estate contract, the seller cannot place a lien or encumbrance of the property except when the purchaser consents in writing and the lien or encumbrance is to improve the property including the installation of utility services. Also, even if a lien or encumbrance is disclosed or consented to by buyer, the seller must notify the buyer within 60 days of any legal action taken against the property.

The seller must provide an accounting of the status of the account under the real estate contract to include among other things, the amount the buyer has paid thus far, the balance due, the estimated number of installments remaining and tax and insurance proceeds. This accounting report must be given by the seller on January 31 of each year during the term of the contract.

The bill describes the seller's remedies on the buyer's default and the buyer's right to cure the default.

The seller's remedies and by consequence the buyer's rights upon default are determined as to whether the buyer has paid more than 20% of the principal or the equivalent of 60 monthly payments. When the buyer has gained an interest on the property because the buyer has paid 20% of principal or 60 monthly payments, the seller must follow a judicial foreclosure or a refinance of the contract can be accomplished with the buyer provided that the new loan not exceed the principal due at the time of default by more than double the amount defaulted upon. If the buyer has not contributed 20% of the principal nor the 60 monthly installments, then the seller may accelerate the contract and enforce the remedies of rescission or forfeiture. Seller must also allow buyer to remove some improvement and compensate for improvements made as determined by certified appraiser.

Section 21 provides different levels of remedies available for violations of REICA depending on the specific alleged and proven violation.

The REICA is effective July 1, 2011.

FISCAL IMPLICATIONS

There will be a minimal administrative cost for statewide update, distribution and documentation of statutory changes. Any additional fiscal impact on the judiciary would be proportional to the enforcement of this law and commenced prosecutions. New laws, amendments to existing laws and new hearings have the potential to increase caseloads in the courts, thus requiring additional resources to handle the increase.

Based on data from the AOC the average cost for a property case in district court is \$432 per case. Since this bill regulates an existing form of contract, it is unlikely that there will be a significant increase in the number of cases. There might, however, be a reduction in the number of cases because this bill clarifies the terms and conditions allowable in real estate installment contracts.

SIGNIFICANT ISSUES

There is no law in New Mexico that directly addresses the regulation of real estate contracts. Other states have enacted similar regulations.

Section 19 provides a definition of an outstanding real estate installment contract to be a real estate contract executed prior to July 1, 2011 but in which the obligations of the seller or the purchaser have not yet been completed. The AGO notes that this raises an important issue: is this provision retroactive? It will apply to real estate contracts that were executed and entered into before the effectiveness of this law which is July 1, 2011, but it provides that it only applies to contracts that are not yet satisfied or completed or are pending and still in force. Furthermore, the requirements are partial requirements and can easily be met by sellers so that the regulation of all pending and existing real estate contracts is enforced uniformly.

Section 18 provides that a real estate installment contract is an extension of credit pursuant to the Unfair Practices Act (UPA). That being the case, then there is no need to add any other type enforcement provisions involving the attorney general as proposed by Section 21, nor the district attorney for that matter. The Unfair Practices Act has already an enforcement scheme that provides for both public and private actions. A much simpler alternative to accomplish what Section 21 attempts to accomplish is to simply include a provision that states that a violation of the REICA is a violation of UPA because entering into a real estate installment contract is an extension of credit and UPA covers the extension of credit. The entire remedies provisions of UPA would then apply in an action under REICA.

When there is a lien or encumbrance on the real property sold under a real estate installment contract and although disclosed to the buyer, it is necessary to assure the buyer that the buyers payments will go first to pay the creditor or lien holder. This would prevent the original creditor, the creditor of the seller from taking action against the subject property. This is accomplished by placing the parties' agreement in escrow, a third and neutral party who will have a fiduciary duty to distribute the proceeds of the buyer's payments timely and correctly. Furthermore, an escrow requirement would also provide the accounting requirements of REICA. There should be a provision that the buyers payment is not paid to seller first when there is a lien or encumbrance. SB 320 does not have this type of escrow provision.

ADMINISTRATIVE IMPLICATIONS

Section 21 provides the AGO or district attorneys the authority to recover actual costs for buyer when seller violates certain provisions of REICA. This provision is inconsistent with the commonly used statutory scheme where the state or county governments do not provide legal representation for individual consumers. When the AGO or district attorneys act legally, they do so on behalf of all consumers affected by the violations of the seller or business but do not represent the individual consumer or person.

TECHNICAL ISSUES

Section 19 Subsection D and E should read January 31, 2012 rather than January 1, 2012.

OTHER SUBSTANTIVE ISSUES

Nearly half of the states in this country have laws that pertain to property sales through REICs, and these contracts continue to be used in those states. These states include Arizona, California, Illinois, Iowa, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Montana, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, and Washington, along with the District of Columbia. Of the states that border Mexico, only New Mexico has no similar statute.

Currently, low-income purchasers who tend to be the purchasers using REICs might not be taking legal action to enforce these agreements because it is difficult for them to find or afford a lawyer. The attorney fee provisions of the REICA are intended to help them obtain legal representation, which may increase the number of these cases filed in court. However, when such cases currently come to court, unraveling ownership is extremely difficult since REICs are seldom recorded as other real estate transactions. The recording requirements of the REICA might streamline these issues in the case, resulting in greater efficiency in case processing. Also, if current cases are *pro se*, the ability to obtain legal representation due to the attorney fee clause would streamline the progress of these cases.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

No uniform guidelines would be available for parties entering into a sale and purchase of residential real property causing a case by case dispute depending on the terms and conditions included in the agreement. While there have been attempts to create model real estate contracts, there is no uniform requirements that must be followed. This creates an array of disputes among parties who have entered into the purchase of real estate contracts.

DW/bym