



**White Paper**  
**SB 756, SD1, HD2, CD1, Relating to the Secure and Fair Enforcement for Mortgage Licensing Act**  
**Act 225**

**By: Nathan Aipa, Esq.**  
**Pitluck Kido & Aipa, LLP, General Counsel**  
**Hawai'i Association of REALTORS®**  
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**Introduction:** SB 756, SD1, HD2, CD1, Relating to the Secure and Fair Enforcement for Mortgage Licensing Act, was signed into law by the Governor on July 9, 2015 and took effect upon its approval as Act 225. This new law establishes a mortgage license exemption for seller-financed mortgage loans under certain conditions. The Act amends Chapter 454F, Hawaii Revised Statutes, by adding a new exemption with specific conditions for a seller-financed mortgage loan under new section 454F-2(10), Hawaii Revised Statutes.

**Background:** The July 2008 Housing and Economic Recovery Act (HERA) contained an element that explicitly addressed the need to increase integrity in the residential mortgage loan market, enhance consumer protection and reduce fraud. The Federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) under HERA called for a nationwide mortgage licensing system and registry (NMLS) by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR), which essentially would provide uniform license applications and reporting requirements for state licensed-loan originators and a comprehensive licensing and supervisory database.

The NMLS, along with SAFE Act-compliant laws was intended to provide increased accountability and tracking of mortgage brokers, a more streamlined regulatory process, and more accessibility to information about mortgage brokers. The SAFE Act required the States to pass SAFE Act-compliant legislation by a specified date, and to participate in a nationwide mortgage licensing system and registry.

Act 32, Secure and Fair Enforcement for Mortgage Licensing Act (Hawaii-SAFE), codified as Chapter 454F, Hawaii Revised Statutes, was passed during the Hawaii 2009 special legislative session, which would become effective in August 2010, but was extended to January 1, 2011 to provide sufficient time to get a proper licensing program established for mortgage loan originators and mortgage loan originator companies. Act 32 made significant changes to the elementary Chapter 454, Hawaii Revised Statutes, regarding the then mortgage brokers and solicitors licensing program. Act 32 followed the model state law, which was developed by CSBS and AARMR in order to assist States in enacting SAFE-compliant legislation. Under Chapter 454F, a "mortgage loan originator" means an individual who for compensation or gain or in expectation of compensation or gain (a) takes a residential mortgage application or (b) offers or negotiates terms of a residential mortgage loan, and (c) includes an independent contractor who has a contractual arrangement to perform mortgage loan originating, underwriting, or loan processing services to a mortgage loan originator. A mortgage loan originator must be licensed under state and federal law unless exempt from such registration.

Initially, Act 32, or Chapter 454F, Hawaii Revised Statutes, completely exempted individuals who conduct loan origination activities on behalf of an immediate family member or for their own residences.

In 2014, however, Hawaii legislative amendments under Act 198 deleted the individual seller financing exemptions in (i) former Subsection 454F-2(2), which read: "Any individual who offers or negotiates terms of a residential mortgage loan with, or on behalf of, an immediate family member of the individual"; and (ii) former Subsection 454F-2(3), which read: "Any individual who offers or negotiates terms of a residential mortgage loan secured by a dwelling that served as the individual's residence." These deletions removed the exemptions that allowed ordinary, non-licensed property owners to provide owner or seller financing to family members or other purchasers of their own home. Consequently, such individuals now needed to meet mortgage loan originators registration requirements.

**New State Seller Financing Exemption:** In light of the urgings made during the Hawaii 2015 legislative session to reinstate the seller financing exemption, SB 756, SD1, HD2, CD1, Relating to the Secure and Fair Enforcement for Mortgage Licensing Act, was signed into law as Act 225 on July 9, 2015, taking effect immediately and thereby establishing a mortgage license exemption for seller-financed mortgage loans provided several specific requirements are satisfied under new Section 454F-2(10), Hawaii Revised Statutes.

**A. Purchase Money Mortgage:** A Purchase Money Mortgage (PMM) between a seller and buyer involves a seller-financed mortgage loan that may be used to facilitate the sale of the seller's property to the buyer. Basically, in using a PMM, the seller transfer legal title of the property to the buyer but obtains a mortgage lien on the property thereby securing the terms and conditions of a promissory note between seller and buyer.

In considering seller financing with a PMM between seller and buyer, seller would constitute a mortgage loan originator unless exempt under new Section 454F-2(10), HRS, as amended. Section 454F-2(10) now permits an exemption to "a seller of real property who offers or negotiates terms of a residential mortgage loan that is financed by the seller and secured by the seller's own real property"; provided that the following conditions are satisfied:

1. Seller is a person, estate, or trust that transacts three or fewer residential mortgage loans in one calendar year [Sec. 454F-2(10)(A)];
2. Seller is not a loan originator for purposes of the loan originator qualification requirements in 12 Code of Federal Regulations section 1026.36(f) and (g) [Sec. 454F-2(10)(B)];
3. Seller has not constructed or acted as a construction contractor for the residence on the property in the ordinary course of the seller's business [Sec. 454F-2(10)(C)];
4. The interest rate for the loan does not exceed the State's usury limit; provided that the exemptions from usury specified in section 478-8 shall not apply to transactions subject to this paragraph [Sec. 454F-2(10)(D)];
5. Seller has provided buyer a current title search including any liens against the Property [Sec. 454F-2(10)(E)(i)]; which is usually provided to buyer pursuant to the Purchase Contract; and
6. Seller provides buyer the terms of the financing including:
  - a. The interest rate [Sec. 454F-2(10)(E)(ii)];
  - b. Monthly principal and interest payments [Sec. 454F-2(10)(E)(iii)];
  - c. Any prepayment penalty [Sec. 454F-2(10)(E)(iv)];
  - d. Any late payment charges [Sec. 454F-2(10)(E)(v)];
  - e. The payment schedule [Sec. 454F-2(10)(E)(vi)];
  - f. The total amount of interest that the mortgagor will pay over the term of the loan expressed as a percentage of the loan amount [Sec. 454F-2(10)(E)(vii)];
  - g. A calculation of projected aggregate monthly payments including principal and interest [Sec. 454F-2(10)(E)(viii)];
  - h. Estimated closing costs if closing costs are included in loan costs and estimated cash to close if closing costs are not included in loan costs. For purposes of this paragraph, closing costs shall include recording fees, transfer taxes, prepaid costs such as homeowner's insurance premiums or property taxes, and appraisal costs charged to the mortgagor [Sec. 454F-2(10)(E)(ix)];
  - i. Seller's contact information including name, address, phone number, electronic mail address, and alternate contact information to the extent available [Sec. 454F-2(10)(E)(x)]; and
  - j. A statement that the seller will acquire a security interest in the buyer's dwelling and that that Buyer may lose the dwelling in the event of a loan default [Sec. 454F-2(10)(E)(xi)].
7. Seller provides a disclaimer that must be initialed by the buyer, which states, "BUYER ACKNOWLEDGES RECEIVING FINANCING FROM THE SELLER IN THIS TRANSACTION AND GRANTING THE SELLER A MORTGAGE. THIS CAN HAVE SERIOUS CONSEQUENCES SHOULD BUYER FAIL TO MAKE ANY PAYMENTS INCLUDING, BUT NOT LIMITED TO FORECLOSURE AND LOSS OF BUYER'S PROPERTY. THEREFORE, IT IS IMPORTANT THAT BUYER UNDERSTANDS ALL FINANCING TERMS AND OBLIGATIONS AND OBTAINS PROFESSIONAL EXPERT ADVICE TO THE EXTENT NECESSARY TO ENSURE BUYER IS FULLY ADVISED IN THIS MATTER" [Sec. 454F-2(10)(F)]; and
8. The residential mortgage loan or Purchase Money Mortgage is recorded with the land court or bureau of conveyances as applicable [Sec. 454F-2(10)(G)].

While the new Section 454F-2(10), Hawaii Revised Statutes, generally reinstates the seller financing exemption in Chapter 454F, Hawaii Revised Statutes that was deleted in 2014, the new 2015 seller financing exemption places a heavy responsibility on the seller to satisfy the above-referenced requirements to avoid the licensing requirements for a mortgage loan originator. The seller and buyer should understand that a PMM has serious legal, financial, credit, and tax consequences. Buyer should understand that the PMM will place a lien on buyer's property and can cause serious consequences if buyer fails to make payments under the terms of the loan or note secured by the PMM, including the right of the seller to foreclose on the property. Both seller and buyer should consult with qualified professionals to ensure compliance with the new requirements under Section 454F-2(10) and to fully understand each of their respective rights and responsibilities under the PMM.

**B. Agreement of Sale:** An Agreement of Sale (AOS) between a seller and a buyer also constitutes a means of seller financing. Under an AOS, the seller typically retains legal title of the property while transferring an equitable interest to the buyer in the same property during the term of the AOS. Upon satisfaction of the terms and conditions of the AOS, the seller then transfers legal title to the buyer. An earlier version of SB 756, SD1, HD2, CD1, Relating to the Secure and Fair Enforcement for Mortgage Licensing Act, namely SB 756, SD1, HD2, specifically included a reference to an "agreement of sale," (as well as "rent-to-own agreement"). Interestingly, Conference Committee Report No. 31, regarding SB 756, SD1, HD2, CD 1 also states, in part, that "[t]he purpose of this measure is to (1) Establish a mortgage license exemption for a seller of real property who offers or negotiates terms of a residential mortgage loan, agreement of sale, purchase money mortgage, rent-to-own agreement, or other loan that is secured by the seller's own real property and for which the seller is the mortgagee or lender and the buyer an mortgagee or borrower." However, the final version of SB 756, SD1, HD2, CD1, which has been signed into law as Act 225 (2015) specifically excludes all references to an "agreement of sale" and "rent-to-own agreement" and expressly states in its preamble that "the purpose of this Act is to establish a mortgage license exemption for seller to engage in seller financing." The new Section 454F(10) also opens with the following: "A seller of real property who offers or negotiates the terms of a residential mortgage loan that is financed by the seller and secured by the seller's own real property." As such, one can reasonably conclude by a plain reading of the new statute that the AOS is not covered under Act 225 (2015).

Nevertheless, as highlighted in the following section regarding the Truth in Lending Act (TILA) and the Consumer Financial Protection Bureau (CFPB), a seller utilizing an AOS may still be considered a loan originator unless the seller satisfies the seller financing exemption requirements under such federal law, rules and regulations. The new Agreement of Sale Addendum, RR203, has been revised to highlight the application of such federal law. Furthermore, as with the PMM, the seller and buyer should understand that an AOS has serious legal, financial, credit, and tax consequences. Buyer should understand under an AOS, seller retains legal title to the property while the buyer only receives an equitable interest in the property. Buyer should understand that an AOS may have serious consequences if buyer fails to make payments under the terms and conditions of the AOS, including the right of the seller to foreclose on the property. As such, seller and buyer should consult with qualified professionals to ensure that they fully understand their respective rights and responsibilities under the AOS.

**C. TILA and CFPB:** Notwithstanding the distinctions made above between a PMM and AOS under the new state law enacted as Act 225 (2015), federal law further complicates the situation as a seller still may be deemed to be a "loan originator" and subject to the registration and licensing requirements under (i) the Truth in Lending Act (TILA), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in 2010 and (ii) new rules created by the Consumer Financial Protection Bureau (CFPB) released in 2013 (Regulation Z).

In response to NAR and many other commentators, CFPB provided some flexibility in the new final rules by excluding from the federal definition of loan originator two categories of seller financing (that may include a PMM or AOS), namely, those that sell three or fewer properties in any 12-month period and those that sell only one property in any 12-month period, and in both cases meet certain specific criteria. Using a PMM or an AOS in connection with the sale of the one property in a 12-month period, the seller may be exempt for such registration requirements under federal laws, rules, and regulation provided: (a) the seller provides financing for the sale of only one owned by seller in any 12-month period; (b) the seller has not constructed, or acted as a construction contractor for a residence on the Property in the ordinary course of business of seller; (c) the financing provided by the seller does not result in negative amortization; and (d) the financing has a fixed interest rate or a qualified adjustable interest rate. There are other exemption guidelines for a person who wishes to sell three or less properties in any 12-month period. Other requirements apply even if seller is not deemed to be loan originator. Reference is made to NAR's publication entitled "Impact of Loan Originator Final Rules on Seller Financing," (February 8, 2013), which is incorporated herein by reference for more details on these exemptions.

New Section 454F-2(10)(B) as recited above incorporates a reference to the above-summarized federal rules indicating overlapping compliance requirements between state and federal rules.

**Practical Considerations for the REALTOR® or REALTOR-ASSOCIATE® (Agents):** Today, seller-financing is a highly regulated area under recently adopted federal and state laws, rules and regulations. In the past, the HAR Purchase Money Mortgage Addendum, RR205 and the Agreement of Sale Addendum, RR 203, were used as tools by Agents to propose seller-financing as an alternative to conventional financing in the sale and purchase of a home. Agents may have completed portions of these addenda and included them in the Purchase Contract compilation of documents constituting the agreement between the parties. These addenda were then used to guide an attorney in the preparation of the actual promissory note and purchase money mortgage or agreement of sale between a seller and buyer.

Today, federal and state laws, rules, and regulations have imposed a greater responsibility on the seller in providing such seller-financing in order to avoid the licensing requirements of a "loan originator." In light of this new highly-regulated legal landscape, Agents should consider the following six practical tips:

1. Agents must avoid the unauthorized practice of law;
2. Agents should advise their clients to seek assistance from qualified professionals, including, but not limited to, an attorney, financial and tax advisor, a banker, and an appraiser, in completing either the PMM Addendum, RR205, which has incorporated the changes of this new state law under Section 454F-2(10), Hawaii Revised Statutes; or the new AOS Addendum, RR203, which now highlights a reference to the new federal regulations;
3. Agents can use the Addenda as a checklist to review the required elements of a PMM or AOS with their clients, but should end such review with a reminder of the written disclaimers provided therein;
4. Agents must not fill in any of the blanks provided in either Addendum unless they are absolutely sure of the information being inserted;
5. Agents may consider including the proposed loan principal amount and interest rate only in either Addendum to initiate an offer for the purchase of a property with seller financing, but ought to leave all other requirements blank until the parties are able to obtain qualified professional assistance and advice in completing the remainder of the forms; and
6. Any question or concerns regarding the use of the revised Purchase Money Mortgage Addendum, RR205 or Agreement of Sale Addendum, RR 203 should be directed to the principal broker or the broker in charge of the brokerage firm for review and determination as to the prudent course of action on the matter.