SANDRA B. McCRAY
ADMINISTRATOR

JAMES T. DILLON
DEPUTY ADMINISTRATOR

UNIFORM CONSUMER CREDIT CODE

The State of Colorado
DEPARTMENT OF LAW

OFFICE OF CONSUMER AFFAIRS
1525 SHERMAN, 2nd Floor
DENVER, COLORADO 80203
Telephone: (303) 866-3611

September 25, 1981

Administrative Interpretation No. 3.104 and 3.109-8101

A "SELLER CARRY BACK" SECOND MORTGAGE TRANSACTION IS SUBJECT TO THE COLORADO UNIFORM CONSUMER CREDIT CODE AS A CONSUMER LOAN UNDER SECTION 5-3-104 IF THE SELLER DOES NOT IN FACT INTEND TO FINANCE THE SALE. "SELLER'S POINTS" CHARGED IN CONNECTION WITH A RESIDENTIAL REAL ESTATE LOAN ARE NOT FINANCE CHARGES WITHIN THE CONTEMPLATION OF SECTION 5-3-109 AND THUS NEED NOT BE INCLUDED IN THE CALCULATION OF THE APR.

The administrator has received several requests for her opinion as to whether certain "seller carry back" credit transactions are subject to the Colorado Uniform Consumer Credit Code (hereinafter referred to as "code"); and, if so, whether the seller's points charged on such transactions must be included in the finance charge. Specifically, the requests received raise two issues:

1. Whether a home acquisition credit transaction secured by a junior lien which is structured as a "seller carry back" transaction is subject to the code as a consumer loan under section 5-3-104 if the seller does not in fact intend to finance the transaction, and

2. If the above transaction is a consumer loan subject to the code, whether the seller's points charged on the transaction are a finance charge under section 5-3-109.

Issue No. 1: Whether a home acquisition credit transaction secured by a junior lien which is structured as a "seller carry back" transaction is subject to the code as a consumer loan under section 5-3-104 if the seller does not in fact intend to finance the transaction.

Currently, the administrator is aware of two categories of home acquisition financing transactions labeled as "seller carry back" transactions. Although the two categories carry the same label, the transactions are entirely different in substance. It is important to understand the distinction between the two categories since only one category of such "seller carry back" financing transactions is subject to the code.

A. Category 1

In the first category is the true "seller carry back" transaction. The owner/seller of the home agrees to finance the sale of his home for the buyer by accepting the buyer's note secured by a mortgage on the home. Generally, the seller finances only that portion of the sale price of the house in excess of the existing (or new) first mortgage loan and the buyer's down payment. In other words, the seller is generally in the position of a second mortgage creditor.1/ The following transaction was presented to the administrator as one example of the true "seller carry back" second mortgage transaction:

Sale price of house	$85,000
First mortgage loan	$55,000
Cash down payment	$13,000
Remaining amount to be financed by the seller	$17,000

In this transaction, the owner/seller agrees to finance the $17,000 for the buyer and "carry back" a second mortgage on the house he is selling. The buyer makes a note for $17,000 payable to the seller and makes his monthly payments on the transaction to the seller. The seller may, some months after completion of the transaction, sell the note to a financial institution or other third party investor. In that event, the buyer will make his payments directly to the third party assignee.

In my opinion, the "seller carry back" portion of the above transaction is not subject to the code. It is, of course, a credit sale made for a consumer purpose. However, it is not a consumer credit sale as defined in C.R.S. 1973, 5-2-104 since the seller is a private party engaged only in the one time sale of his home. As such, the seller is not "a person who regularly engages as a seller in credit transactions of the same kind,..."2/ Since the seller does not meet the

"regularly engaged" threshold test under the code, the entire second mortgage transaction is excluded from code coverage.3/

B. Category 2

In the second category is a transaction which is also labeled as and also initially structured as a "seller carry back" transaction. However, the similarity between the two transactions ends there.

In this second category of transactions labeled "seller carry back", the owner/seller agrees to finance a portion of the sale price of his house only if a third party creditor will purchase the note prior to or at closing. Despite its label as a "seller carry back" transaction, it is not in fact a seller carry back transaction. The seller never intends to finance the transaction and never intends to carry back a second mortgage. Using the same example set forth in paragraph A above, the second mortgage transaction in this second category of "seller carry backs" looks as follows:

Sale price of house	$ 85,000
First mortgage loan	$ 55,000
Cash down payment	$ 13,000
Remaining amount to be financed as follows:	$ 17,000

a. Note from buyer to seller for $ 17,000

b. Prior to or at closing note is sold to a financial institution at a discount of, say, 15%. The seller receives $14,450 from this transaction. Buyer of course pays $17,000 to the financial institution.

The true creditor in this transaction is the third party who makes a loan to the buyer by pre-arranging directly or indirectly the terms set forth in the note and purchases such note from the seller at a discount.4/

My position in this regard is identical to the position taken by the Federal Reserve Board staff in their opinion letters on "seller carry back" transactions. See letters No. 109, 219, 259, 344, and 1323. Specifically, in letter No. 259 the Federal Reserve Board staff took the following position with regard to second mortgage transactions with pre-arranged discounts to creditors:

> This is in reference to your letter ... regarding the problem of the application of the Regulation where the homeowner taking back a second mortgage is merely a conduit for a creditor who will actually hold the obligation. The seller who is not otherwise a creditor ... and who takes back a second mortgage is exempt from the requirements of Truth in Lending, providing he is really the lender in substance. If the seller pre-arranges with a real estate broker or some other professional second mortgage investor to discount the instrument as soon as he (the seller) receives it, then he may not depend on his "non-creditor" exemption. In other words, if the seller is nothing more than a "straw man," he is not the real lender, and existence of the exemption would depend on the status of the discounter, (who, in most cases, would be a "creditor"). Brokers and salesmen should not rely on the homeowner's exemption where a credit instrument is made payable to a "non-creditor" seller if they know that the instrument will be discounted by pre-arrangement, and full disclosure should be made in such cases....
>
> On the other hand, if the seller decides at a later date to liquidate an instrument he is holding, his exemption is still valid. The question as to the identity of the real creditor would only arise when the instrument is discounted by pre-arrangement or, in other words, where the seller never

entertained any thoughts about holding the instrument.

To summarize, it is my opinion that a second mortgage home acquisition transaction in which the seller does not intend to finance any portion of the sale of his home, is subject to the code as a consumer loan under section 5-3-104 if the transaction otherwise meets the requirements of that section of the code.

Issue No. 2: Whether the seller's points charged on a residential real estate acquisition consumer loan are a finance charge under section 5-3-109.

Several persons requesting the administrator's opinion as to the applicability of the code to "seller carry back" transactions have also asked whether, assuming the second category of "seller carry back" transactions is in fact subject to the code, the creditor may exclude any seller's points charged on the transaction from the finance charge. In my opinion, seller's points in such a transaction are not finance charges and thus need not be figured in the calculation of the APR on the loan.

Seller's points are a charge imposed by the lender on the seller of real estate usually in connection with a VA or FHA loan taken by the buyer to finance the acquisition of the home. Prior to the issuance of revised regulation Z in April, 1981, the Federal Reserve Board staff had taken the position that such charge must be included in the finance charge. The staff reasoned that seller's points were charges either paid indirectly by the debtor (through a specific increase in the purchase price of the house) or paid directly by the seller to the lender on behalf of the debtor (since "but for" these points, the seller would be able to accept a lower price.) See the definition of finance charge in regulation Z at section 226.4 and in the code at section 5-3-109.

This position caused significant compliance problems both for lenders who sought to document evidence that the seller did not in fact recoup these points by increasing the purchase price of his home and for regulators who did not have reliable data to determine whether the seller had increased the purchase price of his house to recoup all or a portion of the charge.

As a result of these compliance problems the Federal Reserve

Board in its revised regulation Z excludes seller's points from the finance charge in all cases.5/

The definition of finance charge in section 5-3-109 of the code is substantially the same as the definition under Truth in Lending. Thus the compliance problems noted by the Federal Reserve Board staff under Truth in Lending are identical to those under the code. I concur with the reasoning of the Federal Reserve Board which led to the exclusion of seller's points from the finance charge. Accordingly, seller's points charged by the lender in connection with residential real estate acquisition loans are not a finance charge under section 5-3-109.

1/ The analysis would be the same if the seller financing was secured by a first mortgage except that residential real estate purchase money loans secured by a first mortgage are exempt from many of the provisions of the code. See section 5-3-105..

2/ See section 5-2-104 (1)(a). The "regularly engaged" threshold test is met if the seller engages in more than five (5) such transactions in a year.

3/ Note however that if the amount financed by the seller is $3,000 or less the transaction may be subject to the code as a consumer related sale. See section 5-2-602(1), as amended.

4/ It would be elevating form over substance to conclude that the prearranged purchaser of the note is not the true lender. See Ford Motor Credit Co. v. Cenance, 101 S. Ct. 2239 (1981). In that case, the court determined that disclosure of Ford Motor Credit Co. as an assignee rather than as a creditor was sufficient disclosure of its creditor status since "here, requiring more disclosure would not meaningfully benefit the consumer and consequently would not serve the purposes of the Act."

In this case, however, identification of the pre-arranged purchaser of the note as the lender rather than assignee does meaningfully benefit the consumer since it results in code coverage of the transaction including substantial consumer protection provisions.

5/ Revised regulation Z, section 226.4(c)(5). The purpose of the exclusion is "to avoid difficulty in determining whether purchase prices have been specifically increased to cover seller's points."

By Sandra B. McCray
SANDRA B. MCCRAY
Administrator
Uniform Consumer Credit Code

SBMC:wp

This is an official interpretation of the Colorado Uniform Consumer Credit Code as contemplated in C.R.S. 1973, 5-6-104(4), as amended.