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TO: House Committee on Financial Institutions and Pensions

FROM: Christy Molzen, Kansas Judicial Council

DATE: January 29, 2024

RE: Neutral testimony on H.B. 2101 regulating contract for deed transactions – WRITTEN ONLY

House Bill 2101 is based on the work product of an ad hoc Judicial Council Advisory Committee that was formed in 2020 to study the topic of contracts for deed. I am providing a copy of that committee's report for the legislature's information.

Please note that there is one small difference between H.B. 2101 and the committee's recommendation. In Section 3(a)(3), the committee used "and" instead of "or" between sub (A) and (B). Per the committee's recommendation, a seller could have a preexisting mortgage on property being sold by contract for deed only if the seller both disclosed the mortgage to the buyer and continued making timely payments.

**REPORT OF THE JUDICIAL COUNCIL ADVISORY COMMITTEE
ON 2020 H.B. 2600 – CONTRACTS FOR DEED**

December 11, 2020

COMMITTEE ASSIGNMENT

In April 2020, Rep. Kent Thompson, Chair of the House Committee on Local Government, wrote to the Judicial Council requesting a study of 2020 H.B. 2600, introduced by Rep. Jason Probst. The bill would have created a recording requirement for contracts for deed and deemed any contract not so recorded void and unenforceable. Rep. Thompson asked that the Council review the issues raised by H.B. 2600 and recommend modifications to the bill or alternative legislation.

The Judicial Council agreed to undertake the study and formed a new advisory committee for the project.

COMMITTEE MEMBERSHIP

The members of the Advisory Committee on H.B. 2600 – Contracts for Deed (Committee) are:

Prof. Andrea Boyack, Chair, Professor of Law at Washburn University School of Law; Lawrence

Kellee' Dunn-Walters, Commercial Underwriting Counsel/Manager, Security 1st Title; Overland Park

John Goodyear, Staff Attorney, League of Kansas Municipalities; Topeka

Marilyn Harp, Executive Director, Kansas Legal Services; Topeka

Ed Jaskinia, President, Associated Landlords of Kansas; Kansas City

Joseph Jeter, practicing attorney and Judicial Council member; Hays

Joseph Molina, Director of Legislative Services, Kansas Bar Association;
Topeka

Rep. Jason Probst, State Representative from the 102nd District;
Hutchinson

Kathleen Taylor, Senior Vice President and General Counsel, Kansas
Bankers Association; Topeka

Mark Tomb, Vice President of Governmental Affairs, Kansas Association of
Realtors; Topeka

METHOD OF STUDY

The Committee met four times via Zoom videoconference during the fall of 2020. The Committee reviewed H.B. 2600 and legislative minutes and testimony offered by conferees at a hearing held on the bill by the House Committee on Local Government.

Included in the testimony was a research memo from the Kansas Legislative Research Department, and an article by Heather Way, *Contracts for Deed: Charting Risks and New Paths for Advocacy*, 23 J. Affordable Housing & Community Dev. L. 37 (2014), which described the Texas experience with abuses of contracts for deed and summarized legislative reforms adopted in other states. The Committee reviewed the statutes from many of the states cited in that article including Arizona, Iowa, Maryland, Minnesota, North Carolina, North Dakota, Ohio and Texas.

Attachments

The following attachments may be found at the end of this report:

- Attachment 1 - Study request letter
- Attachment 2 - H.B. 2600
- Attachment 3 - Proposed alternative legislation

BACKGROUND ON H.B. 2600

House Bill 2600 was introduced by Rep. Jason Probst of Hutchinson, who explained that he became aware of a gap in the law after problems arose in his community with properties being sold on contract for deed. Hutchinson had a rental registration program with a goal of ensuring that rental properties met minimum maintenance standards. But homes being sold under contract for deed did not fall within that program because they were not rental properties. Also, an unscrupulous real estate investor in Hutchinson had bought homes on contract, rented them or sold them on secondary contracts, and in some cases defaulted on mortgages on those same homes. Because there was no public record of these contracts, buyers and lenders were caught unaware.

House Bill 2600 would have required the seller to file an affidavit of interest with the county register of deeds within 10 days of the execution of any contract for deed. Failure to file would result in the contract for deed being deemed void and unenforceable. The goal of the bill was to protect buyers, sellers, and lenders by requiring a public disclosure about who has an interest in a property.

Other conferees on H.B. 2600 pointed out that it is the buyer, not the seller, who has an interest in making sure an affidavit of interest is recorded, and that a buyer already has the ability to record their equitable interest. Also, voiding the contract as a remedy would further harm the buyer. The short 10-day filing period was also a concern.

DISCUSSION

The Committee agreed that contracts for deed are a useful tool that can benefit both buyers and sellers. For homebuyers, a contract for deed can be used to extend credit to those who might not otherwise qualify for a traditional mortgage or who can't make a large down-payment. For sellers, a contract for

deed can provide an income stream to a property owner who doesn't want to take on the responsibilities of being a landlord.

However, a sale under a contract for deed typically lacks many of the protections that are present in the traditional mortgage process, such as an appraisal to determine the value of the property, a disclosure of the property's condition, and a title examination. While the parties are free to negotiate for these protections, in reality, contracts for deed are often used by sellers and especially buyers who are unsophisticated and can't afford to be represented by either an attorney or a realtor.

In addition, contracts for deed can be abused by unscrupulous sellers to exploit unwary buyers. For example, a landlord who doesn't want to make repairs to a rental property may offer to sell the property to the tenant instead via contract for deed. Once the tenant becomes a buyer, he also becomes responsible for repairs to the property. While there is nothing inherently wrong with allowing buyers to establish "sweat equity" in a home by making repairs and improvements, buyers often don't understand that, if they fall behind on payments, under the contract they may forfeit any money paid toward the purchase price and repairs or improvements.

Another way that contracts for deed can be abused is when sellers do not disclose prior mortgages or liens on the property or when they place mortgages on the property after the sale. Sellers may collect the buyer's payments but fail to apply them to an outstanding mortgage. In that case, a buyer might make all of the payments required under the contract but never obtain title to the property.

Other common problems that Committee members have seen arise with contracts for deed include incomplete contracts that don't include all the necessary terms, such as the total purchase price, and buyers who are never given a copy of the contract.

While there are no Kansas statutes that specifically address contracts for deed, Kansas courts have sometimes provided an equitable remedy for buyers who have paid a significant portion of the purchase price. See *Stevens v.*

McDowell, 151 Kan. 316, 319-20 (1940) (if monthly payments under contract for deed were made with reasonable promptness and aggregate amount constitutes substantial payment of purchase price, court may require proceedings in equitable foreclosure). Compare *Dallam v. Hedrick*, 16 Kan. App. 2d 258 (1990) (buyers who had paid only 8% of purchase price under installment land contract had not made “substantial payment” that would have precluded forfeiture on default).

An equitable remedy might include providing the buyer a redemption period or compensating a buyer for the amount paid over and above what the fair market rental value of the property was. However, to pursue an equitable remedy in court, a buyer must be able to afford to hire an attorney or be poor enough to qualify for free legal representation.

Kansas is not alone in experiencing problems and abuses with contracts for deed. A number of other jurisdictions have enacted legislative reforms relating to contracts for deed, and the Committee reviewed examples from at least eight different states. Some of those legislative reforms included equity protection for buyers, *e.g.* requiring a judicial foreclosure process if a certain percentage of the purchase price has been paid; providing a minimum period for a buyer’s right to cure a default; contract recording requirements; seller disclosure requirements as to title issues and physical condition of the property; interest rate caps; and bans on prepayment penalties and excessive late fees. See Way, *Contracts for Deed: Charting Risks and New Paths for Advocacy*, 23 J. Affordable Housing & Community Dev. L. 37, 45-47 (2014).

COMMITTEE RECOMMENDATION

The Committee agreed to recommend a two-part approach to address the problems it identified. One part of the solution is to enact some basic protections in Kansas law, but another part of the solution must be education. Education will be addressed in more detail in a later section of this report.

After reviewing the laws in other states, the Committee agreed that there are some basic protections that could be enacted without unduly restricting the parties' freedom of contract. The Committee focused on just four requirements, the first three of which are title-related:

1. A provision to enable recording of either a contract for deed or affidavit of equitable interest.
2. A requirement that the seller have and maintain fee simple title, with some exceptions.
3. A requirement that the seller apply payments to any outstanding mortgage.
4. A provision setting the minimum period for a buyer's right to cure a default after notice.

The Committee's proposed legislation may be found at Attachment 3. The proposal is limited to contracts for deed used in sales of residential real estate, because that is where all of the abuses and problems seem to be occurring. By contrast, agricultural or commercial real estate sales typically involve more sophisticated parties who are usually represented by counsel.

Recording requirement

While current Kansas law does not require that a contract for deed be recorded, attorneys routinely advise buyers under contracts for deed to file an affidavit of equitable interest to put third parties on notice of their interest in the property. This filing prevents the seller from placing a mortgage on the property and it protects the buyer if the seller tries to sell the property again to another unsuspecting third party. Unfortunately, many buyers are not represented by counsel and are not aware of the importance of filing an affidavit of equitable interest.

The bill that was the impetus for the Committee's study, H.B. 2600, included a recording requirement placed on the seller, a 10-day window for the seller to complete the filing, and a penalty provision that would have invalidated

any contract for deed that wasn't filed. The Committee generally agreed with opponents of H.B. 2600 that the filing window was too short, and that invalidating the contract entirely was not the appropriate remedy.

Some Committee members were in favor of requiring the recording of a contract for deed or affidavit of equitable interest. They argued that a public filing would protect not only the buyer, but also financial institutions and other third parties. However, the Committee could not reach agreement on whether the buyer or seller should bear the burden of making the filing, and what the penalty should be for failure to file.

Ultimately, the Committee agreed that it was more important to encourage buyers to file an affidavit of equitable interest through education. The Committee also recommends a statute making clear that register of deeds offices must accept for filing any contract for deed or affidavit of equitable interest presented by any interested party.

Title requirements

The Committee's proposed legislation includes provisions requiring a seller to hold and maintain title to the property being sold, and prohibiting a seller from placing a new encumbrance on the property without the buyer's knowledge and consent. There would be exceptions for encumbrances placed because of the buyer or with the buyer's knowledge to secure a loan for improvements to the property. There would also be an exception for preexisting encumbrances if the seller disclosed them to the buyer and continue to make timely payments.

The Committee recommends making a violation of these requirements a deceptive act or practice under the Kansas Consumer Protection Act. Providing a remedy under the KCPA, which authorizes a court to award attorney fees, might incentivize attorneys to take cases on a pro bono basis.

Right to Cure

Finally, the Committee recommends enacting a statutory minimum time period for a buyer's right to cure a default after written notice. Under the

Committee's proposal, no matter what the contract for deed says, a buyer must be given written notice and 30 days to cure a default if less than half of the purchase price has been paid or 90 days to cure a default if half or more of the purchase price has been paid. The right to cure provision does not supplant a district court's discretion to fashion an equitable remedy, such as requiring proceedings in equitable foreclosure and ordering a longer redemption period in cases where that is appropriate.

Education

The Committee acknowledges that not every problem can be solved by enacting legislation. Education of buyers and sellers about contracts for deed is equally important. To that end, Committee is working to create a sample contract for deed form and checklist for buyers and sellers. The Kansas Bar Association and Kansas Legal Services have expressed willingness to make these documents available for free on their websites where other organizations can link to them.

The Committee's hope is to promote the use of contracts for deed that contain all of the essential terms and clearly lay out the parties' expectations of what will happen in the case of a default.

CONCLUSION

Contracts for deed are a useful tool that should continue to be available to Kansas buyers and sellers. However, because contracts for deed present risks to buyers and the potential for abusive practices by sellers, the Committee believes there are some minimum protections that should be provided by statute. The Committee also hopes to promote best practices in the use of contracts for deed by making a sample form contract and checklist available to buyers and sellers in Kansas.

KENT L. THOMPSON

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April 9, 2020

Nancy Strouse, Executive Director
Kansas Judicial Council
301 SW 10th Ave
Topeka, Kansas 66612

Dear Ms. Strouse:

I am writing to request Judicial Council study of a topic raised by HB 2600, introduced during the 2020 Session and referred to the House Committee on Local Government (Committee). After the hearing on the bill, the Committee voted unanimously to refer the bill to the Judicial Council for more in-depth consideration of the issues raised by the legislation.

HB 2600 would create law that would require an affidavit of interest by the seller for any contract for deed to be filed with the county register of deeds where the property is located within 10 days of the execution of such a contract and void any such contract if the respective affidavit has not been filed.

At the hearing on the bill, the Committee heard from both proponent and opponent conferees that land contracts are neither good nor bad by nature and can be used as a tool to help people become homeowners who might not otherwise be able to do so. The contracts themselves can be as detailed, or lacking in detail, as desired by the parties involved. Proponents expressed a desire to protect potential buyers from bad actors, who in some areas of the state have purchased homes on contract and then rented or sold them on a secondary contract. In some instances, bad actors have even secured and defaulted on mortgages on properties. Without record of a prior contract for deed, there is no pre-emptive protection for lenders and proceedings could potentially require court action. Opponents expressed concern about the practical considerations of the bill such as the 10-day window to file an affidavit. Such a time constraint does not take into consideration possible notifications and title searches and the potential loss of investment for purchasers. One opponent conferee suggested it would be more appropriate to require a purchaser to file an affidavit of interest and noted it would be in their best interest to take such an action.

I would appreciate the Judicial Council's consideration of this topic and any recommendation regarding modifications to the legislation or introduction of alternative legislation. If prudent, I would request that the group assigned to review this topic please approach Representative Jason Probst, District 102, for additional information. Representative

Probst introduced HB 2600 and, at the hearing, he testified that he has worked on this issue for a great deal of time.

Please let me know if I can provide any further information or answer any questions regarding this request.

Thank you,



Representative Kent Thompson, District 9
Chairperson, House Committee on Local
Government



Representative Emil Bergquist, District 91
Vice chairperson, House Committee on
Local Government



Representative Pam Curtis, District 32
Ranking Minority Member, House
Committee on Local Government

KT/mkl

Session of 2020

HOUSE BILL No. 2600

By Representative Probst

2-10

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- 1 AN ACT concerning contracts for deeds; requiring recording of an
2 affidavit of interest with the register of deeds.
3
4 *Be it enacted by the Legislature of the State of Kansas:*
5 Section 1. An affidavit of interest for all contracts for deed must be
6 filed with the county register of deeds where the property is located by the
7 seller within 10 days of the execution of such contract. Any contract for
8 deed for which an affidavit of interest has not been filed shall be deemed
9 void and unenforceable.
10 Sec. 2. This act shall take effect and be in force from and after its
11 publication in the statute book.

Section 1. Definitions

As used in this act:

- (a) "Contract for deed" means an executory agreement in which the seller agrees to convey title to real property to the buyer and the buyer agrees to pay the purchase price in five or more subsequent payments exclusive of the down payment, if any, while the seller retains title to the property as security for the buyer's obligation. Option contracts for the purchase of real property are not contracts for deed.
- (b) "Buyer" means a person who purchases property subject to a contract for deed or any legal successor in interest to the buyer.
- (c) "Seller" means any person who makes a sale of property by means of a contract for deed or any legal successor in interest to the seller.
- (d) "Property" means real property located in this state upon which there is located or will be located a structure designed principally for occupancy of from one to four families that is or will be occupied by the buyer as the buyer's principal place of residence.

Section 2. Recording

Any contract for deed or affidavit of equitable interest may be recorded in the office of the county register of deeds where the property is located by any interested person.

Section 3. Title requirements

- (a) A seller shall not execute a contract for deed with a buyer if the seller does not hold title to the property. Except as provided further, a seller must maintain fee simple title to the property free from any mortgage, lien or

other encumbrance for the duration of the contract for deed. This subsection does not apply to a mortgage, lien or encumbrance placed on the property:

- (1) Because of the conduct of the buyer;
 - (2) With the agreement of the buyer as a condition of a loan obtained to make improvements on the property;
 - (3) By the seller prior to the execution of the contract for deed if:
 - (A) The seller disclosed the mortgage, lien or encumbrance to the buyer, and
 - (B) the seller continues to make timely payments on the outstanding mortgage, lien or other encumbrance.
- (b) Any violation of this section is a deceptive act or practice under the provisions of the Kansas consumer protection act and shall be subject to any and all of the enforcement provisions of the Kansas consumer protection act.

Section 4. Right to cure

- (a) A buyer's rights under a contract for deed shall not be forfeited or cancelled except as provided in this section, notwithstanding any provision in the contract providing for forfeiture of buyer's rights. However, nothing in this section shall be construed to limit the power of the district court to require proceedings in equitable foreclosure.
- (b) The buyer's rights under a contract for deed shall not be forfeited until the buyer has been notified of the intent to forfeit as provided in subsection (c) and has been given a right to cure the default and has failed to do so within the time period allowed. A timely tender of cure shall reinstate the contract for deed.

Attachment 3
Proposed alternative legislation

- (c) A notice of default and intent to forfeit shall:
- 1) Reasonably identify the contract and describe the property covered by it;
 - 2) Specify the terms and conditions of the contract with which the buyer has not complied; and
 - 3) Notify the buyer that the contract will be forfeited unless the buyer performs the terms and conditions within the following periods of time:
 - (A) If the buyer has paid less than 50% of the purchase price, 30 days from completed service of notice;
 - (B) If the buyer has paid 50% or more of the purchase price, 90 days from completed service of notice.
- (d) A notice of default and intent to forfeit shall be served on the buyer in person, or by leaving a copy at the buyer's usual place of residence with someone of suitable age and discretion who resides there, or by certified mail or priority mail, return receipt requested, addressed to the buyer at the buyer's usual place of residence.
- (e) Nothing in this section shall be construed to preclude the buyer or the seller from pursuing any other remedy at law or equity.