

# Lawyer Insights

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## Expert Analysis: Business-Purpose Mortgage Loans Face New Scrutiny In Fla.

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All Florida has enacted a law relating to business-purpose mortgage lending following reports of mortgage lenders circumventing residential mortgage licensing and disclosure requirements under the guise of making business-purpose loans.

On July 1, 2019, Florida's House Bill 935 will take effect. H.B. 935 prohibits misrepresenting a residential mortgage loan as a business-purpose loan and established penalties for violations. The bill, which was approved by Gov. Rick Scott on March 21, 2018, also clarifies an existing licensing exemption for investors who make or acquire a mortgage loan using their own funds, or sell such a mortgage loan.

### An Overview of Florida's Licensing Requirements

Unless otherwise exempt, Florida mortgage lenders require licenses. A "mortgage lender" means a person making a mortgage loan, servicing a mortgage loan for others or, for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, sell or offer to sell a mortgage loan to a noninstitutional investor. For purposes of this requirement, a "mortgage loan" means any:

- Residential loan primarily for personal, family or household use which is secured by a mortgage, deed of trust or other equivalent consensual security interest on a dwelling, as defined in the Truth in Lending Act, or for the purchase of residential real estate upon which a dwelling is to be constructed;
- Loan on commercial real property if the borrower is an individual or the lender is a noninstitutional investor; or
- Loan on improved real property consisting of five or more dwelling units if the borrower is an individual or the lender is a noninstitutional investor.

Based on the above definition, a loan secured by a 1-4 family property is considered a "mortgage loan" only if it is primarily for personal, family or household use. As noted in the final bill analysis of H.B. 935, licensure is not required in order to extend the loan to a borrower who intends to use the loan proceeds for a business

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purpose. This aligns with the coverage of TILA and the Real Estate Settlement Procedures Act, both of which also exclude business-purpose loans.

## The New Law

In describing the original legislation related to this bill, the committee on banking and insurance noted reports of lending entities providing residential loans with usurious interest rates and high fees, and avoiding licensing and disclosure requirements, under the guise of “business purpose” loans. The committee also expressed concern that unlicensed mortgage lenders were making loans to offshore shell companies and facilitating money laundering schemes.

As a result, in 2017, the Florida legislature passed a bill that, among other things, would have removed from the definition of “mortgage loan” the requirement that such loans be primarily for personal, family, or household use. Under this law, borrowers obtaining residential loans for business purposes would have had the same consumer protections as if the mortgage loan was primarily for a personal, family, or household purpose.

Significantly, persons making, brokering or originating business-purpose mortgage loans would have been subject to licensure, unless otherwise exempt. However, the bill was ultimately vetoed by Gov. Rick Scott on June 26, 2017. Similar provisions were proposed in the original version of H.B. 935, although the bill was modified significantly before passage.

While H.B. 935 does not alter the definition of “mortgage loan,” at the heart of the bill are new provisions that make it unlawful for any person in any practice or transaction or course of business relating to the sale, purchase, negotiation, promotion, advertisement or hypothecation (pledging collateral without delivery of title or possession) of mortgage loan transactions, directly or indirectly, to misrepresent a residential mortgage loan as a business purpose loan.

For purposes of this prohibition, a “business purpose loan” means a “mortgage loan, the proceeds of which the borrower intends to use primarily for a business purpose and not primarily for a personal, family, or household purpose. In determining if the loan is for a business purpose, a person must refer to the official interpretation by the Consumer Financial Protection Bureau of 12 C.F.R. § 1026.3(a).”

In other words, the new law incorporates the examples provided in the official commentary to Regulation Z, the implementing regulation of TILA, including the five factor test for determination of whether a loan is “primarily for a business purpose.” These factors are:

- The relationship of the borrower’s primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.
- The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.
- The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.

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- The size of the transaction. The larger the transaction, the more likely it is to be business purpose.
- The borrower's statement of purpose for the loan.

Consideration of these examples and factors from the Regulation Z commentary, and including supporting documentation within the loan files, will be critical to determining whether a loan is for a "business purpose" under the new Florida law.

A knowing violation of this prohibition is punishable as a third-degree felony. If the total value of money and property unlawfully obtained exceeds \$50,000 and there are five or more victims, it is punishable as a first-degree felony.

Finally, H.B. 935 clarifies an exemption under current Florida law that permits an individual investor to make or acquire a mortgage loan with his or her own funds, or to sell such mortgage loan, without being licensed as a mortgage lender, so long as the individual does not "hold himself or herself out to the public as being in the mortgage lending business."

## Takeaways

As evidenced by H.B. 935 and early legislation tied to the bill, states are increasingly scrutinizing business-purpose mortgage activity as the market for business-purpose residential lending proliferates. Since regulation varies significantly by state, lenders making business-purpose loans and investors purchasing such loans should carefully review and consider the licensing requirements in each of the jurisdictions where they do business, in addition to other consumer protection laws that could potentially apply to business-purpose mortgage loans.

In addition to loan purpose, other factors that may impact the licensing analysis are whether the loan is made to an individual or an entity, the type of collateral securing the loan (i.e., 1-4 family, multifamily or commercial), and the occupancy status of the property.

In light of Florida's new prohibition and the penalties associated with violations, and as suggested in the final bill analysis, lenders currently involved in making residential loans for a business purpose may choose to seek licensure in Florida out of an abundance of caution. Although a violation of RESPA or TILA, or their implementing regulations, is grounds for a disciplinary action in Florida, as noted above, business purpose loans are generally excluded from the coverage of TILA and RESPA.

Accordingly, lenders making business-purpose residential mortgage loans that obtain a license may not necessarily be required to provide the disclosures required under TILA and RESPA. However, as noted in the Regulation Z commentary, if a question exists as to the primary purpose for a loan, a lender is free to make the disclosures and the fact that disclosures are made under such circumstances is not controlling on the question of whether the transaction was exempt.

Given the increased scrutiny of business-purpose mortgage loans, when a lender is seeking to rely upon a business-purpose exclusion or exemption from licensing or regulatory requirements, it is essential to

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carefully evaluate and document the business-purpose nature of the loan using the guidance outlined in the official commentary to Regulation Z.

Participants in the secondary mortgage market, such as investors and purchasers, should also take these considerations into account, conduct due diligence for these unique business-purpose requirements and continue to monitor developments in state law that could expand the mortgage lending activities that are subject to licensing and other regulations.

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