

House Bill 5282 (Substitute H-1)
First Analysis (3-24-98)

Sponsor: Rep. Kim Rhead
Committee: Commerce

THE APPARENT PROBLEM:

According to the Real Property Law Section of the State Bar Association of Michigan, Michigan, unlike many jurisdictions, recognizes the sale of both improved and unimproved real estate upon land contract. The land contract sale divides the ownership and economic considerations between the seller and buyer. The seller retains legal title and the buyer obtains equitable title (the right to obtain legal title upon payment of the land contract in full). The seller obtains the income-stream of the land contract payments and the buyer obtains the rights of possession and related rights, such as the right to rental income from a tenant occupying the property.

Some have argued that these economic benefits create assets which sellers and buyers should be able to finance and mortgage in the same way as mortgages upon fee-ownership interests (so-called "real property mortgages"). However, these assets are generally not liquid because most commercial lending institutions are unwilling to lend money secured by a seller's or buyer's land contract interest.

As the Real Property Law Section of the State Bar Association of Michigan points out, the financing of land contract interest is subject to many legal uncertainties. It has been unclear, for example, how such mortgages should be filed and recorded. It is also unclear to lenders whether a land contract mortgage should be treated as a mortgage upon a real property interest, or a personal property interest. Under present law, it is equally unclear whether foreclosure and enforcement remedies are governed by mortgage foreclosure laws or laws involving personal property such as the Uniform Commercial Code. Consequently, land contract interests are not readily financeable.

Some argue that legislation is needed to create a voluntary procedure to allow land contract mortgages, and to make it clear that such mortgages should be treated as real estate mortgages.

THE CONTENT OF THE BILL:

The bill would amend Public Act 237 of 1879, the Land Contract Act, regarding contracts for the sale of land, to allow the creation, recording, and enforcement of a mortgage granted against land contracts in generally the same fashion that is currently allowed for real estate mortgages. House Bill 5282 would add six sections to the act, and would repeal section 5 which governs the proper discharge of land contracts and sets penalties.

A land contract is an installment contract for the purchase and sale of land, wherein the seller or vendor retains title to the property pending payment of the final installment, at which time the title is transferred to the purchaser or vendee. The legal title to the property is retained by the seller until the obligations under the contract are completed. In a mortgage, an interest in land is created by a written instrument that provides security for the payment of the debt. The legal title of the property is held by the mortgagee, but title becomes void on the final payment of the debt by the mortgagor.

The bill would allow either a buyer or seller of property under a land contract to grant a land contract mortgage to secure any debt or obligation that could have been secured under a real estate mortgage. However, any otherwise enforceable contractual provisions that prohibited or provided for the default of the contract for mortgage, sale, assignment, or further encumbrance of the buyer's or seller's interest would not be defeated by the bill's provisions.

The mortgage would extend to the entire interest of the buyer or seller that granted it, unless otherwise provided, in the same fashion and to the same extent as would a real estate mortgage. The interest of the seller or buyer would include, but not be limited to, the seller's right to payment and the buyer's right to conveyance. For the purposes of the bill, these interests would be treated as real property interests. The provisions of the bill would be in addition to

existing legal rights and remedies with respect to financing and encumbering the buyer's and seller's interests in the land contract.

A land contract mortgage could be documented in the same way as would be sufficient to constitute a real estate mortgage, and would have to be in the same form and executed, acknowledged and recorded in the same fashion as a real estate mortgage. The interests encumbered by a land contract mortgage would not have to be specifically identified.

A land contract mortgage could be perfected by having it recorded in the same manner as a real estate mortgage and it would have the same standing as to other interests as a real estate mortgage. No other filing would be required. A land contract mortgage that had been perfected in this fashion would take priority over all other security or other interests in the buyer's or seller's interest except those that would have priority over a real estate mortgage in similar circumstances.

A land contract mortgage could be enforced in the same manner as a real estate mortgage, including judicial foreclosure and foreclosure by advertisement. A party that purchased the foreclosed mortgage interest would obtain all of the mortgaged rights and interests of the foreclosed seller or buyer. A land contract mortgagee would have the same rights and remedies available as would a real estate mortgagee under similar circumstances. Remedies that existed before the bill's effective date would continue to apply; however, a land contract mortgagee would have the option of enforcing a mortgage created under the bill's provisions in accordance with the bill.

A land contract mortgage would not affect the rights or remedies of parties to the land contract other than the seller or buyer who entered into the mortgage. However, if the buyer granted a land contract mortgage to a mortgagee who properly recorded it, the seller would be required to do all of the following: 1) provide the land contract mortgagee with the same notices regarding forfeiture or foreclosure as the seller would be required to provide the buyer; 2) name the land contract mortgagee as a party to any legal proceedings to terminate the land contract; and, 3) accept any cure of default on the land contract made by the land contract mortgagee that would have been accepted were it made by the buyer.

If the seller granted a land contract mortgage, the buyer would be required to continue to make payments

in accordance with the terms of the contract until he or she received notice that foreclosure was completed without a redemption by the seller, after which the buyer would have to continue to pay the contract payments to the successful bidder at the foreclosure. However, if the mortgage contained an assignment of the buyer's payments, the buyer would have to make his or her payments to the mortgagee (after the buyer received a notice of default signed under oath by the mortgagee indicating that a default existed under the land contract mortgage, a copy of the recorded mortgage containing the assignment of the payments, and a demand that all further payments under the contract be made to the mortgagee).

A third party who wished to assert a lien or interest in the mortgaged property over the interest of the mortgagee would be required to give the mortgagee copies of the same notices as were provided to the buyer and seller; name the mortgagee as a party to any legal proceedings intended to terminate the mortgage; and accept any payment, performance, or cure from the mortgagee that would have been accepted if made by the seller or the buyer.

When the buyer had fully paid the contract, the seller would have to convey the land by an appropriate deed. Until the seller named in the contract had ceased in law to be bound to the contract, the obligation to convey the land would remain the obligation of the seller. However, if an assignee who held a mortgage on a land contract assumed the conveyance obligation, the original seller would be only secondarily liable.

When the buyer named in a land contract fully paid and performed the obligations of the land contract, all succeeding assignees and all succeeding grantees would have to make the conveyance of the land to the buyer, as specified in the land contract, or by quitclaim deed if the seller's assignee or grantee had not assumed the seller's conveyancing obligation. When a buyer had fully paid, the land contract mortgagee or the assignee would execute a discharge of the land contract mortgage in the same manner as now provided by law for the discharge of mortgages. A person who failed or refused to do so would be subject to the same penalties as are now provided by law for a refusal to discharge a real estate mortgage after it has been fully paid. Likewise, the party entitled to the conveyance could enforce the conveyance in the same manner as with the discharge of mortgages.

The provisions of the bill would not render a title unmarketable if it would otherwise have been marketable. Neither would the bill void any appropriate subordination to other real estate interests.

MCL 565.351 to 565.355

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

The proponents of this legislation, the Real Property Law Section of the Bar Association of Michigan, point out that this bill creates a 'safe harbor' for prospective lenders and borrowers who seek to lend and borrow money collateralized by land contracts. The bill is intended to supplement existing law which can continue to be used by parties for such loans. The bill will remove existing legal uncertainties and will create an alternative predictable procedure for creating, recording and enforcing mortgage upon sellers' and buyers' land contract interests. To the extent possible, the bill adopts statutory and common law schemes for creating, recording and enforcing real estate mortgages.

POSITIONS:

The Real Property Law Section of the State Bar Association of Michigan supports the bill. (3-18-98)

The Michigan Bankers Association supports the bill. (3-18-98)

The National Bank of Detroit supports the bill. (3-18-98)

Analyst: J. Hunault

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.