

Client Alert

April 2019

Florida to Enhance Scrutiny of Business-Purpose Mortgage Loans

Florida has enacted a law to crack down on 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 (HB 935) will take effect.¹ HB 935 makes it a felony to directly or indirectly misrepresent a residential mortgage loan as a business-purpose loan. The bill, which was approved by Governor 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, a mortgage lender license is required in Florida to make a mortgage loan, service 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.² For purposes of this requirement, a "mortgage loan" means any:

1. 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 (TILA), or for the purchase of residential real estate upon which a dwelling is to be constructed;
2. Loan on commercial real property if the borrower is an individual or the lender is a noninstitutional investor; or
3. 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.³

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 Staff Analysis of HB 935, licensure is not required when the residential mortgage loan is made for a business purpose.⁴

The New Law

Original legislation related to this bill was prompted by 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. 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.⁵ As a result, 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,

¹ A copy of HB 935 is available at: <https://www.flsenate.gov/Session/Bill/2018/935/BillText/er/PDF>.

² Fla. Stat. Ann. §§ 494.00611; 494.001(23).

³ Fla. Stat. Ann. § 494.001(24).

⁴ <https://www.flsenate.gov/Session/Bill/2018/935/Analyses/h0935c.COM.PDF>.

⁵ <https://www.flsenate.gov/Session/Bill/2017/1298/Analyses/2017s01298.bi.PDF>.

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 Governor Rick Scott on June 26, 2017.⁶ Similar provisions were proposed in the original version of HB 935, although the bill was modified significantly before passage.

While HB 935 does not alter the definition of “mortgage loan,” at the heart of the bill are new provisions that make it unlawful 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).”⁷

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

1. The relationship of the borrower’s primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.
2. 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.
3. 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.
4. The size of the transaction. The larger the transaction, the more likely it is to be business purpose.
5. The borrower’s statement of purpose for the loan.⁸

Consideration of these factors, and including supporting documentation within the loan files, will be critical to determining whether a loan is “business purpose” under the new Florida law. A violation of this prohibition is 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 a first-degree felony.

Finally, HB 935 clarifies an exemption under current Florida law⁹ 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.”¹⁰

Takeaways

As evidenced by HB 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

⁶ <https://www.flgov.com/wp-content/uploads/2017/06/HB-747-Veto-Letter.pdf>.

⁷ <https://www.flsenate.gov/Session/Bill/2018/935/BillText/er/PDF>.

⁸ Official Commentary, 12 C.F.R. § 1026.3(a).

⁹ Fla. Stat. Ann. § 494.00115(3).

¹⁰ <https://www.flsenate.gov/Session/Bill/2018/935/BillText/er/PDF>. HB 935 defines “hold himself or herself out to the public as being in the mortgage lending business” to include any of the following: (a) Representing to the public, through advertising or other means of communicating or providing information, including the use of business cards, stationery, brochures, signs, rate lists, or promotional items, by any method, that such individual can or will perform the activities described in s. 494.001(24). (b) Soliciting in a manner that would lead the intended audience to reasonably believe that such individual is in the business of performing the activities described in s. 494.001(24). (c) Maintaining a commercial business establishment at which, or premises from which, such individual regularly performs the activities described in s. 494.001(24) or regularly meets with current or prospective mortgage borrowers. (d) Advertising, soliciting, or conducting business through the use of a name, trademark, service mark, trade name, Internet address, or logo that indicates or reasonably implies that the business being advertised, solicited, or conducted is of the kind or character of business transacted or conducted by a licensed mortgage lender or is likely to lead any person to believe that such business is that of a licensed mortgage lender. *Id.*

are whether the loan is made to an individual or an entity, the type of collateral securing the loan, and the occupancy status of the property.

When a lender is seeking to rely upon a business-purpose exclusion or exemption from licensing or regulatory requirements, it is essential to carefully evaluate and document the business-purpose nature of the loan, including consideration of the five-factor test set forth above. 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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