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NOD & Investor Transactions: Home Equity Sales Contracts

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I. Introduction

A general understanding of the Home Equity Sales Contracts Law (California Civil Code Sections 1695 through 1695.17, referred to as HESC below) is essential for any real estate professional who handles sales of residential properties. This law applies only if ALL four of the following conditions are met:

- (1) the property being sold is residential one-to-four units;**
- (2) the owner currently occupies the property;**
- (3) a Notice of Default (NOD) has been recorded against the property; and**
- (4) the buyer does not intend to occupy the property (i.e., buyer is an investor).**

If any one or more of the four conditions has not been met, then the HESC doesn't apply and none of the conditions or restrictions discussed below apply (e.g., no special contract need be used, there is no special rescission period).

The primary purpose of this legal article is to assist the real estate licensee in adequately and safely handling such a transaction when all four conditions are met, and to present the licensee with a working knowledge of general concepts for dealing with such situations. The highly technical forms, precise language, and exacting notice requirements mandated by law are not included here.

Whenever in doubt of their individual circumstances, readers should seek the advice of an attorney for legal advice in this highly technical area.

Q 1. Why did the legislature enact these laws?

A These laws were enacted in response to practices that occurred in connection with sales of property in foreclosure. Although a variety of schemes were used, the results of such practices were

generally the same. For example, loans, offers of services or sales contracts often involved an unsophisticated homeowner under financial duress signing complex documents with contractual terms which were financially impossible to meet. They frequently included transferring title to the equity purchaser at the same time as the contract was signed, giving the seller no opportunity to consider the transaction. Sometimes, by way of clandestine financial structuring or by hidden transfer language, the homeowner's equity and/or title was mistakenly transferred without the owner's intention to do so. The ultimate result was that the homeowner lost his/her property and/or equity to these unscrupulous individuals.

Q 2. *What is the intent and purpose of Home Equity Sales Contracts law (HESC)?*

A The intent and purpose of this law is to:

- Provide homeowners with information necessary to make informed, intelligent sales decisions;
- Require written sales agreements;
- Safeguard the public against deceit and financial hardship;
- Insure fair dealing in the sale and purchase of homes in foreclosure;
- Prohibit misleading representations;
- Restrict unfair contractual terms;
- Provide homeowners reasonable opportunity to rescind sales to equity purchasers; and
- Protect homeowners' equity.

(Cal. Civ. Code § 1695.)

II. Definitions

Q 3. *What is a Home Equity Sales "Contract"?*

A Basically, a Home Equity Sales Contract is any *contract* of sale between an equity purchaser and an equity seller of a residence in foreclosure. However, see the exemptions in Question 15. (Cal. Civ. Code § 1695.1(e).)

Q 4. *In the above general definition, the word contract has been emphasized. Why is that?*

A The law defines a Home Equity Sale Contract in very particular manner. This contract is defined as any contract, agreement, or arrangement, or any term thereof between an equity purchaser and equity seller incident to the sale of a residence in foreclosure. However, the Code additionally defines an equity contract as any offer incident to the sale of a residence in foreclosure between these parties. (Cal. Civ. Code § 1695.1(e).)

Q 5. *Why would a mere offer be given the same protection as a contract?*

A Here again, the law provides a far-reaching special protection to residential owners in foreclosure. Even before entering into a traditional contract, it is unlawful for any person to initiate or negotiate a sale of a residence in foreclosure to an equity purchaser if the person takes unconscionable advantage of the seller. (Cal. Civi. Code § 1695.13.)

Q 6. Who is an equity purchaser?

A An equity purchaser is defined as any person who acquires title to any residence in foreclosure unless exempt as discussed in Question 15 (Cal. Civ. Code § 1695.1(a)).

Q 7. What is a "residence in foreclosure"?

A A residence in foreclosure means residential real property consisting of one-to-four family dwelling units one of which the owner (seller) occupies as his or her principal place of residence, and against which there is an outstanding notice of default properly recorded (Cal. Civ. Code § 1695.1(b)).

The court of appeal has found this law to apply only when the owners/victims actually live in the residence subject to foreclosure. (*In re Phelps*, 93 Cal. App. 4th 451 (2001).)

III. Legal Effects

Q 8. What actions must the equity purchaser avoid?

A This law require precise and exact conduct of the equity purchaser and the various prohibitions are as follows:

- Do not make any untrue or misleading statements regarding value, proceeds, contract terms, seller's rights, or obligations (Cal. Civ. Code § 1695.6(d));
- Do not induce equity seller to execute or accept any executed instrument of conveyance until the seller's 5-day cancellation period has elapsed (Cal. Civ. Code § 1695.6(b)(1));
- Do not record any instrument of conveyance signed by the seller until the seller's 5-day cancellation period has elapsed (Cal. Civ. Code § 1695.6(b)(2));
- Do not transfer or encumber or purport to transfer or encumber any interest in such property to any third party until the seller's 5-day cancellation period has elapsed (Cal. Civ. Code § 1695.6(b)(3));
- Do not pay equity seller any consideration until the seller's 5-day cancellation period has elapsed (Cal. Civ. Code § 1695.6(b)(4));
- Return any documents signed by equity seller within 10 days following receipt of notice of cancellation, without any conditions (Cal. Civ. Code § 1695.6(c)).

Q 9. What are the remedies of an equity seller in the event these laws are violated?

A An equity seller has been provided a multitude of legal rights under these laws in addition to the traditional legal rights of a party to a contract. If the equity purchaser violates any requirements in Question 8 or takes unconscionable advantage of the owner in foreclosure, the seller may file a court action for recovery of all damages, injunction, other equitable relief, or a combination of these remedies (Cal. Civ. Code § 1695.7).

Furthermore, fraud or deceit upon the equity seller may result in criminal penalties on the equity purchaser up to \$25,000 or up to one year in jail (Cal. Civ. Code § 1695.8).

Q 10. What are the damages that an equity seller can recover?

A In an action for damages, the equity seller can recover:

- Actual damages;
- Attorney's fees and costs; and
- Mandatory exemplary damages in an amount not less than three times the seller's actual damages or a civil penalty of up to \$2500 if no exemplary damages are awarded. (Cal. Civ. Code § 1695.7.)

Q 11. What are the legal rights of an equity seller under the HESC?

A The seller has the following legal rights:

- **FIVE-DAY CANCELLATION PERIOD:** Cancellation of the purchase contract by the equity seller for five full business days from when the equity seller signs the contract or up to 8:00 a.m. of the trustee's sale date whichever occurs first;
- **TWO-YEAR CONTRACT RESCISSION PERIOD:** Rescission of any transaction found to be unconscionable within two years of recordation of the conveyance (Cal. Civ. Code § 1695.14);
- **NO WAIVER BY SELLER:** Any waiver of any provision of these laws by the equity seller is void (Cal. Civ. Code § 1695.10); and
- **NO LIMITATION ON PURCHASER'S DAMAGES:** Any contract provision which attempts or purports to limit the liability of the equity purchaser from damages resulting from the statement or conduct of his/her representative is void (Cal. Civ. Code § 1695.16).

Q 12. Who is a "representative" of the equity purchaser?

A Under the law, a representative of the equity purchaser is a person who in any manner solicits, induces, or causes any property owner in foreclosure to transfer title to the equity purchaser (Cal. Civ. Code § 1695.15(b)).

A representative of an equity purchaser is also a person who solicits any member of the property owner's family or household to induce or cause the equity seller to transfer title to an equity purchaser (Cal. Civ. Code § 1695.15(b)).

Q 13. What does HESC require of a representative of the equity purchaser?

A A representative of the equity purchaser must:

Provide written proof to the equity seller that the representative has a valid, current "California Real Estate Sales License" (Cal. Civ. Code § 1695.17(a)(1));

Provide a written statement, under penalty of perjury, that the representative of the equity purchaser has the above license. The written statement under penalty of perjury must be provided to both the equity seller and equity purchaser prior to transfer of any interest in the subject real property. (Cal. Civ. Code § 1695.17(a)(2).)

Should these requirements not be fulfilled, the equity seller may choose to have the purchase contract voided by the court. Even if the seller cancels, the equity purchaser is liable for all damages caused by the failure to comply with these requirements. (Cal. Civ. Code § 1695.17(b).)

C.A.R. form DPL, "A Declaration and Proof of Real Estate License" satisfies this written statement requirement.

Q 14. What about the bond requirement found in Civil Code Section 1695.17?

A The Fourth District Court of Appeal in *Schweitzer v. Westminster Investments* held that the bond requirement under Civil Code Section 1695.17 for an equity purchaser's representative is "void for vagueness under the due process clause and may not be enforced." The California Supreme Court has declined to review this case which means that the previous bond requirement has been eliminated from HESC. (*Schweitzer v. Westminster Investments*, 157 Cal. App. 4th 1195 (2007), review denied March 26, 2008.)

Equity purchasers and their representatives, however, must still comply with the other requirements of HESC as discussed in this article.

IV. Exemptions from the Home Equity Sales Contract Law (HESC)

Q 15. When does HESC not apply?

A HESC applies only if ALL four of the following conditions are met:

- (1) the property being sold is residential one-to-four units;**
- (2) the owner currently occupies the property;**
- (3) a Notice of Default (NOD) has been recorded against the property; and**
- (4) the buyer does not intend to occupy the property (i.e., buyer is an investor).**

If any one or more of the four conditions has not been met, then HESC does not apply and none of the conditions or restrictions discussed in this article apply (e.g., no special contract need be used, no give-day cancellation period, and there is no two-year rescission period). (Cal. Civ. Code § 1695.1.)

In addition, HESC does not apply when a buyer acquires title in the manner as follows:

- By a deed in lieu of foreclosure of any voluntary lien or encumbrance of record;

- By a deed from a trustee acting under the power of sale contained in a deed of trust or mortgage at a foreclosure sale;
- At any sale of property authorized by statute (such as a tax sale);
- By order or judgment of any court (such as probate or family law court); or
- From a spouse, blood relative, or blood relative of a spouse. (Cal. Civ. Code § 1695.1(a).)

Q 16. *What if an notice of default (NOD) is recorded while the transaction is in escrow or right after the contract is signed but before opening escrow?*

A The language of Civil Code Section 1695.1(b) in defining a "residence in foreclosure" refers to a residence against which there is an outstanding recorded notice of default. HESC does not address the issue of whether the law applies if the NOD is recorded after the execution of a sales contract. There is no appellate case dealing with this issue. However, a Riverside County Superior Court has considered this issue and has made the determination that HESC does not apply if the NOD has not been recorded at the time the parties entered into the sales contract. (*Davis v. Varney*, Case No. RIC 425604.)

With no recorded NOD, the transaction is not subject to HESC when the parties sign the contract. It certainly does not seem reasonable to make the transaction subject to HESC and to force a purchaser, in essence, to start all over again just because an NOD is later recorded.

Unfortunately, a superior court decision is not binding law. Thus, the law is not clear on this issue.

V. Agency and Other Issues

Q 17. *Is a real estate licensee subject to the civil and criminal penalties imposed by HESC when representing the equity seller or equity purchaser?*

A No. HESC imposes these penalties on the equity purchaser. (Cal. Civ. Code § § 1695.7, 1695.8, 1695.15, 1695.17(b).) Of course, all the penalties for violation of the real estate law and laws governing fiduciaries still apply.

Q 18. *My buyer claims to be purchasing for the purpose of using the property as a personal residence. However, I don't feel comfortable about that statement. What should I do?*

A Normally a licensee is not responsible for the hidden undisclosed true intent of a buyer. However, be aware of possible red flags that may arise. For example, the conduct and actions of the buyer may raise questions about his/her veracity when the loan application indicates non-occupier status or title vesting in another person. You may want to urge the buyer to comply with HESC to avoid the potential civil and criminal penalties to which the equity purchaser is liable. (Cal. Civ. Code § 1695.8 (\$25,000 fine and/or imprisonment in jail for a up to a year).)

Q 19. *Does C.A.R. have the applicable forms required by this law?*

A Yes. The following forms for HESC transactions are available at <http://store.car.org> or on [WINForms®](#):

- **Notice of Default Purchase Agreement (C.A.R. Form NODPA).** The NODPA is the

purchase agreement to be used for HESC transactions printed in the statutorily-required format.

- **Declaration and Proof of California Real Estate License** (C.A.R. Form DPL). The DPL satisfies the duty of the representative to provide proof .

- **Notice of Cancellation of the Notice of Default Purchase Agreement** (C.A.R. Form HENC). The HENC is the form for the equity seller to use if the seller desires to cancel the sale within 5 business days of signing the contract. Two copies of the HENC must be completed in full except for the equity seller's signature. The cancellation date and time to be written on this form is midnight of the date 5 business days after the equity seller signs the contract or 8:00 am of the trustee's sale if that will occur sooner (Cal. Civ. Code § 1695.4(a)).

Q 20. *Where can I get more information on the subject?*

A This legal article is just one of the many legal publications and services offered by C.A.R. to its members. For a complete listing of C.A.R.'s legal products and services, please visit *C.A.R. Online* at www.car.org.

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