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Richard Sennott, Star Tribune

New Minnesota law puts light on contract for deed

- Article by: JEFFREY MEITRODT
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Natasha Osborn didn't get an appraisal when she bought her house in Brooklyn Park. If she had, she would have found out she was agreeing to pay 56 percent more than the city thought the property was worth.

She didn't check to see if there were any unpaid liens, either. That would have told her that the previous occupant had left behind more than \$1,000 in unpaid traffic tickets, which she inherited when she purchased the house in late 2011 through an unusual but increasingly popular option known as a "contract for deed."

"These kinds of contracts are way over my head," said Osborn, 26, a first-time home buyer who has repeatedly run into problems with her property. "I had no idea what I was in store for."

As of Aug. 1, real estate novices like Osborn should have a much better understanding of the pros and cons of these contracts before they sign a deal.

Under a new law passed in May by the Legislature, many sellers will have to provide a notice that spells out some of the drawbacks of such purchases and suggests that prospective buyers obtain an appraisal and inspection before finalizing their contract for deed, among other steps. Failure to provide such notice could result in penalties of as much as \$7,500 for the sellers.

Minnesota legislators said they were galvanized by a Star Tribune report in January that showed some property owners have used contract-for-deed sales to trick buyers into deals they can't afford and don't understand. Most of the 1,330 deals reviewed by the newspaper featured high interest rates, large balloon payments or other contract terms that almost guarantee a buyer will default. In hundreds of cases across the Twin Cities, sellers failed to provide mandated home inspections that would have revealed code violations and safety hazards.

Sen. Scott Dibble, a Minneapolis lawmaker who sponsored the legislation, said the new law "addresses a lot of the problems you identified in your story. ... I think there is a lot of abuse out there."

The popularity of contract-for-deed deals soared during the recession, as Minnesota families with credit problems were unable to obtain mortgage financing to buy real estate.

Unlike a traditional home sale, a contract for deed typically takes place with no bank, no Realtor and little government oversight. Instead, the seller finances the sale and collects monthly payments, much like a landlord. Some Twin Cities properties have been sold repeatedly by the same seller, sometimes within months of another sale, after an initial buyer defaulted, records show.

"I hope it settles the market down a bit," said Rep. Jim Davnie, DFL-Minneapolis, who pushed for the legislation. "Ideally, we'll see less churn on properties that sell on contract for deed."

The new requirements cover "multiple sellers," defined as individuals or companies that sell at least four residential properties on a contract for deed in a 12-month period. Originally, proponents of the new law wanted to include anybody who sold more than one property per year, but that idea was opposed by the Minnesota Association of Realtors.

"The new law doesn't interfere with those situations where a father sells a property to a son," Davnie said. "That kind of thing may happen once or twice in a lifetime."

Paul Eger, chief lobbyist for the trade group, said it doesn't make sense to target people who have not been the source of complaints to legal aid groups around the state. Eger said his group also helped make sure the new law exempts contracts in which a buyer is represented by a licensed real estate broker or salesperson. Also exempt are deals in which buyers are represented by an attorney.

It is not clear whether all high-volume sellers will comply with the new law. Three sellers featured in a previous Star Tribune story on contract-for-deed abuses did not respond to questions or refused to comment.

But some sellers said they like the new law and hope it helps clean up the marketplace.

"I absolutely think people need to be protected," said Jamison Kohout, vice president of Real Assets LLC, a St. Cloud company that has sold more than 100 residential properties via contract for deed since 2009. "I routinely tell people to do a Google search to look up horror stories on contract for deed before moving forward. I think that is the best thing you can do — educate the buyer."

Unlike some investors, who have used contract for deed as a way to dump physically troubled properties onto unsuspecting buyers, Kohout said his company spends heavily to make sure its homes are up to code.

Earlier this week, he showed off the company's latest remodel in Brooklyn Park. The foreclosed home, which Real Assets purchased for about \$100,000 from a bank, received a \$70,000 makeover. The kitchen features new hardwood floors and gleaming stainless steel appliances. The furnace and hot water heater have been replaced with new equipment and the smell of freshly laid carpeting lingered.

"We took a total mess and turned it into a home that the new homeowner will be proud of," Kohout said.

Kohout said his company will earn a profit of about 10 percent on the sale. By contrast, other contract-for-deed sellers have marked up their homes by 50 to 100 percent, according to a review of local sales and assessment records.

State legislators agree that contract for deed is a good way to sell real estate in certain situations. They said the law is aimed at helping buyers avoid budget-busting deals and hidden defects.

"There's a real problem out there with landlords scamming people," said Rep. Joe Mullery, DFL-Minneapolis. "They're putting people into rentals and then turning those agreements into contract-for-deed sales without even telling them about it. ... I think some of those landlords will keep doing it because they think they won't get caught."

Legislators acknowledge that enforcing the new law will be difficult. No state agency has been charged with overseeing the market or rooting out abuses. Instead, the new law simply gives buyers the legal right to sue sellers for failing to provide proper notice about potential pitfalls. Buyers can collect actual damages or \$2,500, whichever is higher. Sellers can be forced to pay triple damages if buyers can show they "knowingly" failed to follow the law.

"I think it's a good first step, but in terms of the actual protections it offers, I think it may not be broad enough," said Connie Sandberg, who oversees St. Paul's housing sale inspections. "Enforcement is problematic."

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