



Episode 944: Another Way Government Makes Housing Expensive

Guest: Jeff Watson

WOODS: I had a listener who heard you somewhere, either at an event or on a podcast or somewhere, and said this guy is very well spoken, very interesting, and he's got a lot to say about misplaced government regulation, extremely imprecise in its target and what the consequences of that can be. Now, before we get into any real, flesh and blood examples of this, can you for a lay audience explain exactly what the particular part of Dodd-Frank that affects you is and what you hope might be done about it?

WATSON: Oh, excellent question, Tom. Thank you so much for asking. There's one particular targeted fix that we're aiming for with Dodd-Frank and it has – actually, its origins go back to the SAFE Act, which then was made worse by Dodd-Frank. And it began in the SAFE Act where government began to restrict individuals as to what they could do with their own real property and limited the number of transactions that an individual or an entity could perform in a given year, specifically seller finance transactions. This is where I own a piece of real estate, and I agree as a term of the sale to accept payments over time, rather than cash up front, rather than bank proceeds from a loan upfront, I want you to make payments to me over time. Yes, I may have an interest rate in there; yes, I may have an early payoff, call later, feature later, or so on, different things like that. But with the SAFE Act, I went from being able to do that with as many houses as I owned to now I could only do that with five per calendar or per 12-month period of time.

And then Dodd-Frank took it down to three, and when Dodd-Frank said, when you do three, you can do the first one this way where you can make it to where there's a balloon payoff provision at 60 months or thereafter and you can change the interest rate 60 months thereafter, but if you do a second or a third one in that same 12-month period of time, well, you can't put those same provisions in the second and third note, in terms of the sale that you negotiate with buyers number two and three. So this is where Dodd-Frank literally steps on you and shackles you down as to what you can and can't do with your own capital, with your own assets.

WOODS: What is the official rationale for this?

WATSON: The official rationale is the same official rationale we always see thrown around here. We need to protect consumers.

WOODS: But how had they been abused by this practice in the past that they would need this protection?

WATSON: Well, you see, this is where an all-encompassing dragnet was thrown out by those in Washington, D.C. and those on Wall Street that think that they know more than anybody else, and they took us all in and treated us all the same. They treat me that I try to sell mobile homes on fair, affordable terms the same as if I was a regional bank with \$29 billion of assets. But it's all under the rationale of protecting consumers, to make sure that people can afford the house that they're buying.

WOODS: It just doesn't seem like the one has a whole lot to do with the other. Whether somebody can afford to buy something doesn't seem to have anything to do with putting burdens on you.

WATSON: Well, that's exactly right, because I've got new for you. I am far more interested in someone's affordability on making the payments to me than that mortgage broker or the loan officer or the underwriter is at the bank that's then going to sell that pool of notes off to Freddie Mac, Fannie Mae, or somewhere else. Because if they can't afford to make the payments to me, who suffers? I do.

WOODS: Yeah, of course, you do.

WATSON: It's my capital that's at risk. I'm no longer receiving the income. Now, if a loan officer goes out and makes a bunch of loans that the people can't make the payment after two or three payments, what happens to him? Absolutely nothing. For those of you that don't believe me, please go watch the movie *The Big Short* again. Look at when they interviewed the two mortgage brokers in the movie down there in Florida. The dudes were boasting about how they could get people into houses. Did they care if they got paid? No, they didn't care. They got their money and they're gone, you know?

WOODS: So I guess what I want to know so that people can get this better is what would it look like – if you were to describe to me what the real-world consequences of a regulation like this are for real people who just want to get into some modest house somewhere, how does this actually affect them? It would seem a bit obscure to most people.

WATSON: Well, you would think it would be obscure, but it's really come down and it's really gotten painful in a couple of areas. And I'm going to give you three areas that it's caused disruption in the marketplace. The last of the three is the individual investor like me. We've managed to survive, adapt, and adjust. If I can't sell it, I guess I just have to rent it. But that's the least one.

The biggest thing that we've seen, and this is where I've looked several members of Congress right in the eyes and I go, Dodd-Frank is allowing banks to redline in ways that the most severe racist could have never envisioned being able to do 25, 30 years ago.

WOODS: How does that work?

WATSON: Dodd-Frank has basically made to where banks don't make money originating loans at about \$100,000 or down. So if you're going to go buy an asset, if you're going to go apply to borrow money to buy a house at \$100,000 or down, which, by the way, encompasses huge sections of the Midwest of this country – huge, vast sections, okay? – banks don't make money. They have no incentive to make those loans.

WOODS: I see. Okay, so in other words –

WATSON: They have no incentive to make those loans. They're not making those loans, and so guess where that hurts people. That hurts people that live in rural areas. That lives people who live in inner-city areas.

WOODS: Okay, help me to understand exactly what is the exact mechanism by which it's become unprofitable to finance homes of that value.

WATSON: The amount of regulation and cost that is now imposed by Dodd-Frank on generating or originating a loan is now where lenders, banks don't make money, because they're captive to what profit they can make – I can understand that – their cost in originating a loan and doing the extra disclosures and processing now make it unprofitable for them when they're only lending \$100,000 or less, because, let's face it, when you only lend \$100,000 and you're lending it at today's interest rates, there is not a lot of profit being made there.

WOODS: So in a way, it's somewhat analogous to – I have a business near me where they sell stationery and stuff. They also have post office services. But they won't take credit cards because once you take credit cards, you've got to take them for everything, and they're saying people will come in and they'll charge one postage stamp on a credit card. We can make profit if they're going to charge 10, 20, 50, \$100; can't make a profit on such a small charge.

WATSON: Correct.

WOODS: So I suppose it's an analogous thing with this.

WATSON: It's very similar to that. Exactly, Tom; it's very similar to that. But where it really gets frustrating then is now you have individuals that have been priced out of the market based upon their income, based upon what they do for a living, based upon where they live. Most of the houses that are out there are in this price target of, say, \$60,000 to \$100,000. That's the typical home in the town that I live in. I know there's going to be people who are going to be listening to you and I; they're going to go, That's not where I live. Folks, we're not talking about coastal cities. I'm not talking about an East Coast, West Coast, Florida Coast. Central Florida's got these properties. They're all over this country when you start looking for them. Rural areas, inner-city areas, they're there. And people can't buy these houses.

The other thing is Dodd-Frank has now made the underwriting criteria so severe that a lot of individuals, especially those who are self-employed, can't buy houses till they've been successfully self-employed for three to five years. They've got to have three years of tax returns, which means they have to have been in business for four plus

years to finally generate those tax returns to finally get an underwriter to go, Okay, yeah.

So this is a thing that seller financing solves these problems. We're filling a gap that Dodd-Frank has created, but Dodd-Frank is handicapping us because Dodd-Frank says, Oh yeah, you want to fill that gap, you want to sell your assets? That's fine, but you can only sell three of them in 12 months.

WOODS: Yeah.

WATSON: Now, I don't know about you, I don't know about your listeners, but I think that people who own their houses are better neighbors than people who rent the houses. I know the National Board of Realtors has come out with an amazing statistic that says that people who own houses have ten times or more net worth than long-term renters. And so these are the things that we're trying to say, Hey, listen, what you're doing with this portion of Dodd-Frank is contrary to what you want to do over here. We're trying to raise the boats of everybody. We're trying to let everybody have an opportunity that wants to and can afford to become a homeowner, that has the responsibility of doing it. And believe me, I'm more concerned about their ability to pay than anybody else is because the checks have got to come to me.

WOODS: Now, maybe I'm just — I apologize if I've been in some sort of bubble given that — I've bought several houses that I at least initially borrowed money on and I went the conventional route, went to the local bank, worked it all out. And then I'm reading this memo — this is from I guess a member of Congress, Roger Williams. I think you sent this to me.

WATSON: Right, he is the author and original sponsor of H.R. 1360, which is the Seller Finance Enhancement Act, yeah. Great man.

WOODS: Yeah, so I want to talk about that in a minute, exactly how we would fix this. But he says — just as a little bit of background for people listening because I just didn't know about this world. He writes, "For generations, seller financing has been a preferred form of financing for low-income homeowner transactions and has allowed thousands of individuals who would not otherwise be able to own their own home the opportunity to settle down and become homeowners. The seller can be a private individual, a small company, or a group of investors who function as a direct lender financing the sale of property or goods."

Well, up until today — I can't be alone in this — I didn't know that there was this option. So I just want to make sure everybody's following along with what it is that we're talking about, which is that we want all these options to be available to people, particularly given that the traditional bank option is increasingly being taken away because the banks find it unprofitable even to engage in these transactions.

WATSON: Exactly, exactly. I just had a lady that is a 20-some-year employee of a local community bank sitting in my office last week, and she looked at me and she said, The direction that our new CEO is taking us is we're going away from being a community bank and we want to be a business bank. We want more commercial accounts. And I'm

thinking, why? What happened to taking care of – what happened to banking for people? We're getting this trend, and so it's creating this demand, and then we can't satisfy the demand.

I have people that come to me and they want to own a home. They want to buy a home. They come to my colleagues; they come to my friends; they come to the other members of the Seller Finance Coalition. They go, We want to buy a home, but I've been self-employed for two years, or, I have an irregular income, or, I have this or I have that. And I've had some people just simply say, I don't want to deal with banks. I want to do a private party transactions because you I can trust. You I can have an eyeball-to-eyeball conversation with a rational human being. With a bank, it's always some sort of computer-generated system. And I'm like, I totally respect that. There are people who want to do that.

Now, just to give you an idea, seller-financed transactions are probably about 7% of all the real estate transactions that happen in any given market at any given time. So it's really a lot more than you think it is, and every one of our 50 great states has laws on their books governing certain kinds of these transactions. So it's an accepted, understood process that's been around for decades.

WOODS: So then on top of all these existing regulations in the 50 states, now you get this additional series of layers coming from the federal government.

WATSON: Exactly. Now, I had no problem with the different states governing how real estate is bought and sold in their state. Every state's got laws on their books saying, Hey, these are the rules about how you buy and sell real estate. This is what a deed has to say. These are requirements regarding recording mortgages. This is the terminology that must be in a land installment contract or deed or whatever it's called in every state. That's good. Everybody needs to know what those rules are. That is codification of principles of English common law that came across to the United States hundreds of years ago, and we've just adapted it, gone forward, and made a great, productive society with it. That's all great.

But now we've got people in Washington, D.C. who are writing policy, implementing that policy, and when I talk to them about these things, they look at me and they don't understand what they've done. And in the huge law of unintended consequences, seller financing people like members of the Seller Finance Coalition, we got blindsided First we got clipped hard by the SAFE Act, and then we got steamrolled by Dodd-Frank.

WOODS: And then meanwhile, as somebody like me who's involved more in the theoretical aspect of all this – I mean, I'm not anywhere near your industry, but I'm interested in it because it's another case of – you like to say unintended consequences, but after a while you wonder could somebody really be this dumb that every single thing they do has an unintended consequence that hurts people? But anyway, let's give them the benefit of the doubt and say it's an unintended consequence.

WATSON: Just – I don't know. Yeah, philosophically speaking, my attitude it this: every government action has some sort of reaction –

WOODS: Exactly –

WATSON: – and you've got to be prepared for it –

WOODS: – but people miss those –

WATSON: – so the less government does, the better, in my opinion. I'll leave it at that.

WOODS: Right, okay. Yeah, well, you're singing from my hymn book when you say that, so to speak. But then what happens is they do things like this that cripple parts of the economy that would help people who most need it, and then when therefore there's less help for those people, we then get lectured to about how, Well, I guess a market economy just won't provide for these people. Well, no, not when you have a hammer over the heads of people who are trying.

WATSON: Exactly. If you tie my feet together, please don't complain about my race times.

WOODS: Exactly. So tell me about what – First of all, the Seller Finance Coalition. Give me a word about that and what it is you're trying to see done at the federal level.

WATSON: Sure, excellent. The Seller Finance Coalition is a group of free-enterprise individuals, some companies, some private individuals, all coming together for the purpose of supporting the passage of H.R. 1360. We're going to have a companion bill dropped in the Senate fairly soon. And the idea behind this bill is a very simple, narrow-focused adjustment on Dodd-Frank and the SAFE Act. And we've compromised; we've worked with community bankers, mortgage bankers; we've worked with the National Association of Realtors; and we've come to a number where if we could just simply say, Listen, instead of limiting me to three by Dodd-Frank or instead of leaving me handcuffed at five by SAFE Act, let me just go up to 24. Just let me do 24 of these transactions in a 12-month period of time, because that's going to satisfy the vast majority of our members' needs. I'm going to be selling a mobile home in the next hour. I'm going to be doing the paperwork on it, and it would be a whole lot easier for me to be keeping track of, Okay, I've got 23 more I can do between now and July of 2018, rather than going, Oh, I can only do two more between now and July of 2018.

WOODS: Yeah, as you say, you can do rentals, but otherwise you can't even run a business on those terms.

WATSON: Exactly.

WOODS: Well, then, hold on a minute.

WATSON: Let me just give you one other thought. Let me just give you one other thought.

WOODS: Okay.

WATSON: Somebody's going to be listening to me going, But Jeff, why do you really need to do 24? Let me give you this scenario —

WOODS: Okay, I will say that my listeners will not, but let's imagine a hypothetical person who would.

WATSON: Okay, so let me give you this scenario. Grandma and granddad have worked long and hard and they built up a portfolio of just ten free and clear rental properties. Now, granddad has hit about 72 years of age, and he just looks at grandma and he says, You know what? I'm done with tenants, toilets, turnover. I'm done with it. And they're like, We want to do something different. And about the same time, the doctor tells granddad, Your back is so bad, you can't do anything more. Now, granddad would like to be able to sell all ten houses in the next year. Dodd-Frank says, Oh no, dude, you can only do it over the next three and a third years. Now, how do you think that impacts his life planning? How do you think that matters for estate planning purposes? How do you think that affects things?

WOODS: Yeah, yeah.

WATSON: And so it doesn't understand the economic reality that's hear in the heartland of America.

WOODS: And yet — you know, look, I'm sure there are a lot of people who just reflexively supported Dodd-Frank because they thought they were cracking down on those rich people, when as in so many cases, it winds up coming and biting them because they don't read it. Or moreover, it wouldn't exactly surprise me if traditional financial institutions saw that people like you were struggling and thought, Well, good. Less competition for us. Wouldn't surprise me if that was their mentality.

WATSON: It could be. It could be. I don't want to attribute that to them, but I will say this —

WOODS: No —

WATSON: — Dodd-Frank is making certain banks extremely rich.

WOODS: But generally, those are not the local community banks, which struggle in ways that are probably comparable to the way you do.

WATSON: Exactly.

WOODS: They have to come up with compliance officers. They need at least an extra employee and office space and whatever. And the number of new banks being created has been decimated under Dodd-Frank, and it doesn't seem coincidental.

WATSON: Oh yeah, the number of banks out there is rapidly shrinking. It's rapidly shrinking, and I think that if you're outside the, say, top 12, top 14 big banks in this country, you're struggling to survive.

WOODS: What do you think the prospects are for some kind of regulatory reform under the current administration?

WATSON: Under the current administration, the prospects for regulatory reform are very, very encouraging. Very encouraging. The biggest challenge that we have right now is getting certain things to move through the obstructionist portions of Congress. There are multiple members of Congress that I have spoken to who have looked at me and said, It makes sense, but my party line won't let me do this.

WOODS: Yeah. Yeah.

WATSON: Or other people have looked at me and said, Yes, we understand that this is a very narrow-focused, targeted fix, but what about the CHOICE Act? And I look at them and I smile and say, The CHOICE Act is great, but the CHOICE Act completely ignores us.

WOODS: Right, the CHOICE Act, for people, has been proposed as a way of dealing with Dodd-Frank, but it leaves unchanged the problem of seller financing.

WATSON: It completely ignores us. It's like they didn't even know we existed, and so we've got to address that, and so we are.

WOODS: But it seems like the easy way to pitch this is not, You should worry about my small corner of the real estate world, but rather, Here's a painless way for people to get financing for inexpensive homes. I mean, you could easily – this would take one little measly vote on a technical issue no one understands, and you could pitch it to your constituents as, I'm doing everything humanly possible to get people into homes. That seems like a win-win for everybody.

WATSON: It does, and I'm going to tell you the good news that we've had in the past and how I think it will translate going forward, okay? H.R. 1360 is the third time this bill has been introduced. The previous session of Congress under the last administration where we had a Democrat in the White House, Republicans controlling the Senate and the House, we had some very interesting cosponsors of that bill, identical version to 1360. Some of those cosponsors were former Congressman Mulvaney, who is now inside the White House as the Budget Director. We also had former Congressman Alan Grayson, who did not run for reelection last fall, Democrat from Texas. We had Congressman Bobby Rush from Chicago. We anticipate Congressman Rush is going to come back on board. So we've got individuals that are from political extremes against each other, but on this particular issue, they see it the same way. They see how this is a fix that helps the people in their communities have a better chance at buying a home.

WOODS: Yeah. Yeah. Well, I mean –

WATSON: And I'm going to be straight at you. One of the reasons that I believe Congressman Rush's office is on board with this and has been in the past is that right now, his constituents can buy stuff in Chicago at under \$100,000 that ten years ago

was selling at over a quarter of a million dollars. But right now, banks won't make those loans.

WOODS: Yeah, exactly.

WATSON: Now, go figure. I can buy it today for under 100, but a bank won't make a loan, but ten years ago, I could buy it for a quarter of a million, and banks were begging me to come take their money.

WOODS: Yeah, yeah.

WATSON: Go figure.

WOODS: Geez.

WATSON: And so he sees that this is a solution to where his constituents can be able to buy. And he's right.

WOODS: Yeah, no kidding.

WATSON: And so I've got people from both extremes that are in support of this legislation, so what it really comes down to is we've just got to get past a few obstructionists and away we can go.

WOODS: Well, if people want to know more about this or get more details, are there any – I can put links up on my page. Is there a place you can send them to right here?

WATSON: Sure, absolutely. SellerFinanceCoalition.org.

WOODS: Got it, okay. So that's where people can get more information about this. I mean, chances are, even though I have a pretty big audience, not that many are going to be directly involved, but we all agree that if this is something that makes it harder for low-income people to get a house, then we want to help, right? We want to see this changed.

WATSON: Now, this is not necessarily just for low-income people to buy a house. Yes, it helps them, but also –

WOODS: No, sure, but that's the selling point.

WATSON: – it allows people who own these houses to sell them.

WOODS: Right, but to me, that's the key – that's how you get your foot in the door –

WATSON: Oh, I agree.

WOODS: – and then you spell out the rest. Right.

WATSON: Oh, I completely understand where you're coming from on that one. And I'm just going to take a little bit of a risk here, Tom, if I may. I'm going to take a little bit of a risk.

WOODS: That's what the show is all about. Go ahead.

WATSON: One thing that my research in the last couple years has shown me is there is a really strong and significant correlation between the real estate investing community that wants to be able to do this with those properties and people who are very strong Second Amendment rights individuals.

WOODS: I wouldn't be surprised if there was a correlation there either.

WATSON: And so I have a feeling that many of your listeners are avid fans of the Second Amendment.

WOODS: They are, but they also don't need to be convinced about the rights of property and to dispose of my property as I wish. They're absolutely on board.

WATSON: Some of your listeners may have an occasional rental property that they may look at and say, Hey, you know what? It may make sense for me to sell this and be the bank. So instead of collecting rent, I now get regular payments, but I don't have to worry about fixing something when it breaks because the other guy now – who's buying the houses, who owns the house, who gets the tax benefits of those houses, of being the homeowner – they now have to take care of it.

WOODS: Right, that does sound attractive.

WATSON: Many of your listeners might be in that category.

WOODS: Yeah, oh, no doubt, especially as they get older. And then if they're going to be told that you can only do this on a small scale and it's going to be a regulatory nightmare, well, as you say, that takes away their ability to plan for their own financial futures. And it removes attractive options they would otherwise have exercised, and it basically makes everybody worse off, from people who might have lived there on down from the owner himself.

WATSON: Yep. One of the last comments I'll make on this, Tom, because it's right in this is, as I've looked at various members of Congress and I've said, You know, the IRS lets us sell stuff and encourages us to sell stuff on an installment basis, where, as a term of the sale, we get paid for it over time, and that helps us better manage our tax strategy, but Dodd-Frank interferes with that. The SAFE Act interferes with that. And I get a member of Congress – I've gotten several of them to nod their head in agreement and go, Yeah, you've got a good point there.

WOODS: Huh. Yeah, "You've got a good point there. Now get out of my office," unfortunately, with so many of them. I hope this turns out well. I see Jim Bridenstine's name as a cosponsor.

WATSON: Yes.

WOODS: I got to know him once and I liked him, so I'm glad to see him on board. But I hope this works out. I hope it works out. As you say, the time seems right for regulatory relief, and certainly there are people in positions of power now who are sympathetic. At the same time, you have a party that's in a bit of disarray because of all of the controversy coming out of the White House. I hope this shakes out in your favor.

WATSON: I certainly do too, but I have to tell you I'm very optimistic. I'm very optimistic because what I see this as is here's an opportunity where we can show members of Congress, both in the House and the Senate, here is a true, legitimate, bipartisan piece of legislation. Members of both parties, members from both ends of the parties are on board on this particular bill. It's a very narrowed-focused relief designed to help people be able to buy a house, and it's really designed towards the low- to average-income individual. Push this thing through, that way you now have a chance to go home and tell your constituents you either worked on a bipartisan piece of legislation that granted some sort of limited regulatory relief, or you can go back and tell your people that you helped to get rid of part of Dodd-Frank – whatever message you need to say.

WOODS: Yeah, yeah, exactly. Yeah. I like both of them, but some audiences will like one or the other, but whatever works. Well, Jeff, I appreciate your time and I'm glad you're out there fighting this particular fight. And you know, I hope you're able to break open the champagne really soon.

WATSON: Well, I'm looking forward to that and I will keep you posted. Fair enough, my friend?

WOODS: Thanks a million, Jeff. Appreciate it.

WATSON: Okay, peace.