



SELLER FINANCING 101

LEARNING THE BASICS ON HOW SELLER FINANCING WORKS

Outline

- Learn the differences between Seller Financing, Installment Land Contracts, Lease-Option Agreements and Lease-Purchase Agreements
- Explain basic terms used for Seller Financing and how Seller Financing works
- Pros and Cons of Seller Financing for both Buyer and Seller
- FAQs about Seller Financing
- Important statutes that are applicable when considering Seller Financing
- Contract language for Seller Financing Transactions
- Questions

Definitions

Seller Financing:

Also referred to as Owner Financing, is an arrangement where the Seller of a property acts as the Lender instead of a bank or other financial institution. Buyers make payments directly to the Seller, effectively cutting out any intermediary.

Installment Land Contract:

A contract for the sale of land providing that the Buyer will receive immediate possession of the land and pay the purchase price in installments over time, but the Seller will retain legal title until all payments are made and includes an executory contract for conveyance of real property, a contract for deed, a land contract, and a land sales contract.

Definitions

Lease-Option Agreement:

In a lease-option agreement, the property is leased, often at above-market rates. In exchange, some of the money paid towards rent is usually set aside for a rent credit, which can go toward the down payment and a traditional mortgage down the line. Under a lease-option agreement, the Buyer has the right to purchase the property during or at the end of the lease agreement pursuant to the terms of the contract, but is under no obligation to purchase the property.

Lease-Purchase Agreement:

The main difference between a lease-option and a lease-purchase agreement is that, with a lease-purchase agreement, and subject to conditions, at the end of the lease term the Seller has the obligation to sell the property and the Buyer has the obligation to purchase the property.



How does Seller Financing Work?

- Seller financing works like any traditional mortgage transaction, except the seller extends the financing rather than a bank or mortgage lender. Unlike a traditional mortgage closing, the only money the seller usually receives at closing is the amount negotiated for a down payment – if any.
- Buyer and Seller negotiate the details of how the loan will be structured and repaid. The Promissory Note will specify the interest rate, payment amount, term and any other pertinent information that pertains to the loan. These terms should be listed in the contract under Special Stipulations. (sample contract language to follow)
- An attorney drafts the Deed of Trust, Promissory Note, Warranty Deed and any other documents necessary to complete the transaction. (Just like a standard closing)
- Title Company records the Warranty Deed and Deed of Trust in the public records and disburses funds to the appropriate party.

Is Seller Financing Available for Everyone?

No. The Tennessee Residential Lending, Brokerage and Servicing Act requires a license for any person, or agent of a person, who either (i) owner-finances more than 5 properties in a 12-month period, or (ii) holds themselves out* to the public as being in the mortgage lending business.

*The term “holds themselves out” is not statutorily defined. An agent who indicates “owner-financing available” in the MLS listing (or in the notes) may trigger a licensing requirement for the seller.



Consideration for Agents

If a Seller of an investment property wants to offer seller financing, a good practice is to avoid indicating, offering, or representing that seller financing is available in the MLS listing (instead of waiting for a buyer to make the offer). If that happens, your client risks violating the be “holding yourself out to the public” as a lender. In short, it is best to NOT be the first to propose the idea of seller-financing.



What Happens if the Buyer Defaults?

The consequences and penalties for defaulting are outlined in the Promissory Note and/or Deed of Trust. Those consequences can include:

1. A lawsuit for the unpaid amounts that remain pursuant to the Promissory Note
2. The commencement of foreclosure proceedings
3. A decrease in the Buyer's credit score and inability to obtain future financing

And those are only some risks from defaulting on the payment.



Is Seller Financing a Good Idea?

Owner financing has pros and cons for both the Buyer and Seller. Let's run through the advantages and disadvantages.



Buyer Pros

- It allows borrowers who may not qualify for a traditional mortgage an opportunity for homeownership.
- The closing process may be quicker and cheaper.
- Down payment amounts are negotiable with seller financing, unlike traditional mortgages.
- No PMI.
- There is often less underwriting and credit analysis.
- It can buy time to get one's credit and broader financial picture in order before applying for a traditional loan.

Buyer Cons

- Because Sellers assume risk by financing the purchase, they typically charge a higher interest rate than standard mortgages. For this reason, if you can qualify for a traditional mortgage, that may be a better option.
- Seller-financing is typically not amortized over a traditional 30-year period. As a result, Buyers must be prepared to refinance their obligations or otherwise save enough funds to satisfy a balloon payment of the remaining loan balance at the end of the loan term. Because the final payment can be a significant financial burden, Buyers in seller-financed agreements typically try to secure traditional financing before the balloon payment is due.
- If the Seller doesn't report your on-time payments to one of the three major credit bureaus (which is customary for traditional lenders), the Buyer won't see any improvement to their credit score.



Seller Pros

- Sellers can sell their homes without concern that a Buyer's lender will cancel approval prior to closing. Buyer payments can serve as an additional passive income stream (to the extent the payments exceed the Seller's mortgage payments).
- Subject to usury laws, Sellers can set a higher interest rate than they would earn on other investments.
- Sellers can charge points and other additional closing cost to help generate more financial incentive (keeping in mind that certain loan fees and costs are factored into the usury calculation as interest).



Seller Cons

- Seller assumes the entire investment risk. Consider that the reason someone is asking for financing is likely because they can't qualify for a traditional mortgage.
- If Seller has a current mortgage, then they'll need to obtain the lender's approval before agreeing to provide financing to avoid the consequences of a due-on-sale.
- If Buyer defaults on the terms of the loan, Seller must initiate foreclosure proceedings and/or a lawsuit, which may require hiring an attorney.
- A resident facing eviction may neglect to maintain the property.
- Selling to a Buyer with a traditional mortgage may take longer to close – but Seller gets lump-sum check at closing. With seller financing, Sellers don't receive as much money upfront and must count on monthly installment payments to repay the loan.



FAQs about Seller Financing

1. What are typical terms for seller financing?

The loan terms will depend entirely on what's negotiated between the two parties. In general, seller financing usually has higher interest rates than other loan types, shorter repayment periods (e.g., 3-5 years), and a potential balloon payment at the end of the loan term.

2. Can Seller require copies of Buyer's credit report, proof of funds, job verification?

Yes, the Seller is entitled to review anything that a traditional lender would require from the Buyer. Sellers should self-underwrite to mitigate the risk of default by determining the Buyer's creditworthiness and history of defaults/legal action.

FAQs about Seller Financing

3. Does Seller Financing count toward Buyer's credit score?

Seller financing can count toward your credit score if the Seller reports payments to one of the three major credit bureaus, but reporting payments isn't required unless agreed upon in the contract.

4. Who holds the title with Seller Financing?

The Buyer will be the owner of the property. At closing, the Seller will execute and deliver to the Buyer a deed to the property as outlined in the contract.



FAQ'S about Seller Financing

5. Is Seller Financing worth it?

The answer depends on the circumstances. For Sellers who are having a difficult time finding a traditionally financed buyer, or who do not mind being a lender and receiving deferred payments instead of a lump sum, it could be considered a beneficial business decision. For Buyers who desire home ownership and cannot otherwise qualify for a loan, and who have confidence they will be able to refinance the property within several years or satisfy a lump sum, the rewards may outweigh the risks. However, there are risks associated as covered in prior slides. Each party is encouraged to consult a financial advisor and counsel to ensure this structure satisfies the parties' investment strategies and contains legally sound contractual provisions.



How does the Agent get Paid?

1. Real Estate Agents are paid according to the terms of the Listing Agreement. The most common way for the Agent(s) to get paid commission when Seller Financing is involved is from the Buyer's down payment.
2. This should be negotiated at the time the contract is presented to the Seller, if not already covered in the Listing Agreement..
3. Other options are for the Agent to be paid a percentage from each monthly installment to Seller (risky because the agent's receipt of full commission depends on the Buyer not defaulting); paid directly from the Buyer (if no commission is offered to the Selling Agent) or paid when Seller receives payment in full.



Understanding Usury Laws

What is usury and why do you need to know about it?

Usury is the illegal action or practice of lending money at an unreasonably high rates of interest. Many parties unintentionally violate usury statutes, which can have significant monetary and non-monetary consequences, to include forfeiture of interest, fees, and special damages.

Applicable statutes:

T.C.A. 47-14-117: Usury or excessive charges for contracts.

T.C.A. 47-14-112 Usury a Misdemeanor – Penalty. The willful collection of usury is a Class A misdemeanor.



Seller Financing Contract Language

Sample Stipulation – Not Legal Advice. A Seller-Financing transaction can be complex, and counsel should be engaged to ensure the parties are aware of the consequences of the contractual obligations and applicable laws.

Of the Purchase Price for the Property, Buyer shall pay to Seller an amount of \$_____ in immediately available funds at Closing, inclusive of the application of the Earnest Money Deposit. The remainder of the Purchase Price shall be paid through Seller-Financing, which shall be in the form of a Promissory Note, in the amount of \$_____. The Promissory Note shall be secured by a first priority Deed of Trust on the property. The Promissory Note and Deed of Trust shall be in the form attached hereto in Addendum 1, which shall not be amended without the written consent of both parties.

Questions

1. First time fee waiver (\$550)
2. Attorney at every closing
3. Free online title calculator
4. Dedicated processor for your transactions
5. Payload – Digital Earnest Money Payments

