

Seller Financing - Q & A

Q: What are the benefits of seller financing?

A: Seller financing offers benefits to both buyers and sellers including tax breaks for the seller as well as offering an alternative when conventional loans can't be found.

The risks involved are the same risks facing any lender. Is the borrower a good credit risk? Will the property hold enough value over time to allow for the repayment of all loans made against it?

Sellers should run a full credit check on the borrower, require hazard insurance on the property and include a due-on-sale clause. There also are financing, disclosure and repayment-term requirements that should be met.

Q: How are the rates set for seller financing?

A: The interest rate on an owner-carry loan is negotiable. Ask your agent to check with a lender or mortgage broker to determine the current rate on institutional first (or second) loans.

Seller financing typically costs less than conventional financing because loan fees (points) typically aren't charged. The interest rate on a seller-carry loan will also be influenced by current Treasury bill and certificate of deposit rates. Sellers usually aren't willing to carry a loan for a lower return than they would earn if their money was invested elsewhere.

Q: What is seller financing?

A: Homeowners who are anxious to sell often consider seller financing, which may include taking back a second note or even financing the entire purchase if the seller owns the home free and clear.

Seller financing differs from a traditional loan because the seller does not give the buyer cash to complete the purchase. Instead, it involves extending a credit against the purchase price of the home while the buyer executes a promissory note and trust deed in the seller's favor. These special circumstances must be acceptable to the lender who makes the first mortgage on the property.

The necessary paperwork is prepared by the title or escrow company after the terms are worked out between the buyer and seller.

It is critical to thoroughly evaluate the creditworthiness of the buyer first. Fear of default makes many sellers reluctant to take back a second. But seller financing can bring a higher price plus complete the sale sooner in some situations.

Resources:

* IRS Publication 537, "Installment Sales." Order by calling (800) TAX-FORM.
