Owner Financing - How Does it Work

Ask a seller to give you owner financing to purchase the home he has for sale and most likely you will get a "No." Sellers for the most part automatically reject the suggestion of owner financing because no one has explained that option to them as a way to sell their home. As a seller, should you consider financing or partly financing your buyer? Owner financing can be a valuable and lucrative tool in a seller's toolbox, providing he understands exactly what he's getting into.

Owner Financing

Traditionally, a buyer gets a loan from a third party lender i.e. a bank, credit union etc… in order to finance the purchase of a property. Owner financing (A.K.A. seller financing, owner carry-back, seller take-back) however, is an agreement in which the *seller* of a property agrees to provide (all or part of) the financing to the buyer for the purchase of that property.

When to Use it

Any time you want to! At any given time there are many buyers out there who are ready and willing to buy, but are unable to do so. They have money in the bank for their down payment but their credit score is not good enough to qualify for conventional financing. Offering seller financing is a good way to make your listing stand out of the crowd. In a buyer's market, if your property is not selling, offering owner financing might just do the trick.

Types of Seller Financing

- **Agreement for Deed:** (or Land Contract or Contract for Deed). In an agreement for deed, the buyer only gets equitable title, and is permitted to take possession of the property. Legal title will only be conveyed when the loan is paid in full (hence, agreement for deed).

- **Trust Deed or Deed of Trust:** A trust deed is a written document used to secure a loan on real estate. Three parties are involved in the transaction: the trustor (the buyer/borrower), the beneficiary (the seller/lender), and a neutral third party called the trustee. The borrower transfers bare legal title of the property to the trustee to be held as security for the lender pending fulfillment of payment.

- **Lease Option or Lease Purchase:** Simply put, it's a lease with an option to buy. This means that you are going to sign a lease agreement to lease the property, and you are going to sign an option agreement to sell the property (to be executed at the buyer's option) at a particular time in the future, under specific terms and conditions spelled out in the agreement. A Lease Purchase is basically the same thing but the buyer *has* to purchase the property instead of it being an *option*. Both are considered Rent-to-Own programs. Typically, part of each rental payment is set aside for the purpose of accumulating funds toward the down payment and closing cost, or it can be applied against the purchase price.

Whole or Partial Financing

Sellers can finance the entire balance - or any part thereof - this may or may not include an underlying loan. If there is no underlying loan in place, the seller can finance the entire amount, or the buyer can get a loan from a lending institution for one part while the rest is carried by the seller.

If there is an underlying loan in place, the new loan will be wrapped around the existing one (or the existing loan can also be paid off with a new loan from an institutional lender). For example, a seller has an existing loan in the amount of $60,000.00 and he sells his home with owner financing for $100,000.00. The buyer puts $10,000.00 down and borrows $90,000.00 on a new mortgage, from the seller. This new mortgage will wrap around the existing $60,000.00 loan (hence a wrap-around mortgage).

Benefits to the Seller

The biggest benefit to the seller is that he can command a higher sales price, buyers are generally agreeable to a higher price in exchange for private financing. Other benefits would be 1) tax breaks, 2) potentially higher interest rates, 3) monthly income, 4) shorter marketing time, and 5) because you are willing to get paid in installments you will earn more money in the long run, beyond just the sale price. If you have never looked at an amortization schedule I encourage you do so – you will be amazed, remember that in this case you are the bank!

Benefits to the Buyer

For the buyer, the biggest benefit is simply being able to buy a house rather than not being able to. The reason for this is that the seller will have different, and hopefully, less stringent qualifying criteria than an institution. Some other benefits are 1) lower closing cost: buyers will not have to pay origination fees or loan discount fees, 2) faster move-in time, financial institutions will have a longer qualifying and underwriting process than an individual seller, 3) Flexible financing term: within the guidelines of applicable usury laws, buyer and seller are only limited by their imagination, as long as they both agree, they can pretty much do whatever they want.

Good luck!

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As an investor himself, as well as a licensed Realtor®, Dimitri has over a decade of real estate experience. Dimitri's specialties include primary residences, second homes, investment properties, commercial properties and land. He has been recognized for being a Multi-million Dollar Producer, and is an accomplished Realtor® committed to superior results for his clients.

"*Strive not to be a success but rather to be of value*" *Albert Einstein*