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Cover story: Seller financing rare but can be useful

By Michele Lerner

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When Nina Haeringer and her husband found their dream home for their retirement near Colonial Beach, Va., they also found their dream financing arrangement.

"We had heard that the elderly couple living in this home were getting ready to put it on the market from a friend of ours who knew exactly what we were looking for," Mrs. Haeringer says.

"We met the couple and their daughter as they were closing up the house and shook hands on a price outside the front door that very day," she says. "We called them up later that day and asked if they would be willing to hold the note rather than have us arrange conventional financing through a bank, and they agreed to that, too."

Mrs. Haeringer says she and her husband had been looking for a one-level home with a boat ramp and a boat dock, and this home meets their needs perfectly.

"We were able to save a lot of money for the sellers and for us, since no real estate agents were involved and the closing costs were a lot cheaper," Mrs. Haeringer says. "We used the same lawyer for the closing, so we felt like both sides were equally represented."

Mrs. Haeringer says they made a down payment of 20 percent and have a 30-year fixed-rate loan.

"When interest rates came down, we asked the sellers if they would lower our rate to 4.5 percent, and they did," Mrs. Haeringer says. "The sellers are getting the interest payments as income, and we are getting the same loan we would be getting with a bank. All we paid at the closing was the fee to the lawyer and the filing fees for the settlement."

While not all seller-financing arrangements work this smoothly, Mrs. Haeringer is offering seller-financing on her home in Arlington, Va., which she is selling on her own through SellFinanced.com. She is seeking an offer with a down payment that will pay off the remaining balance on her loan, and then she would like to negotiate a private loan with the buyer to finance the rest of the purchase.

Seller financing, in which the home sellers arrange for mortgage payments to be made directly to them instead of to a bank, is a rarely used method of buying a home. Joseph Gentile, vice president of Federal Title & Escrow Co. in the District, says that less than .05 percent of the company's settlements involve seller financing.

A few years ago, when lenders were offering 80-10-10 loans — mortgages for 80 percent of the purchase price, a 10 percent down payment and a 10 percent second trust loan — some sellers were willing to finance the second trust. Those loans are rarely available today, so in most cases, sellers must finance the entire purchase, minus any down payment. The sellers typically either have a very low balance on their current mortgage that can be paid with a buyer's down payment or own their home free and clear. The U.S. Census Bureau's American Community Survey for 2009 showed that about 32 percent of all homes in the U.S. are owner-occupied properties without a mortgage.

Michael Kiefer, a Realtor with Green DC Realty in the District, recently offered seller financing on a property he was listing, mostly as an enticement because the home has been on and off the market for three years.

"Usually when a seller offers financing, it is because a property is hard to sell for some reason," Mr. Kiefer says. "For the most part, the sellers own the property free and clear of a mortgage."

Mr. Kiefer says sellers benefit from offering financing because often they are given a full-price offer when financing is included and they want the return on their investment from the interest payments.

"There may be tax advantages, too, if the sellers would have had to pay capital gains tax, since the sale will not take place all in one year," Mr. Kiefer says. "Sellers who want to offer financing should consult with a tax adviser to see how this will help or hurt them on their taxes."

Brian Martucci, a mortgage broker with GetLoans.com in the District, says sellers sometimes offer financing because they can earn more interest on their money by offering a loan than they can on money-market accounts or certificates of deposit, which often have rates at less than 2 percent.

"I don't really recommend that sellers offer financing because they cannot do as deep a credit check as a conventional lender and they may get burned by someone who stops making payments," Mr. Martucci says.

In Mrs. Haeringer's case, she and her husband have excellent credit scores and had the cash on hand for a 20 percent down payment. More often, however, the buyers who opt for seller financing do so because they have damaged credit and cannot otherwise qualify for a conventional home loan.

"The buyers who are attracted to seller financing like it because usually their closing costs are lower and the hassle factor of dealing with a lender will be less," Mr. Martucci says. "A seller will often just pull a simple credit report and ask for one or two pay stubs, while mortgage brokers and lenders require a lot more paperwork."

Seller financing can work well when relatives are lending to each other. Occasionally, parents will opt to finance their adult children's loan to make it easier for them to qualify. The parents benefit by earning interest on funds they otherwise might just have given to the children.

Whether the seller financing involves relatives or is an arm's-length transaction, both sides should have an attorney representing their interests to structure the arrangement.

Attorney Patrick F. McLister, with Salisbury & McLister Attorneys at Law in Frederick, Md., says, "It is important that the seller and buyer work with a competent real estate settlement attorney to prepare the promissory note and mortgage. Both parties need to be given an amortization schedule to keep track of their payments as they are made and their [tax] deductible mortgage interest."

Mr. Kiefer says sometimes buyers interested in seller financing are interested in developing a property, and financing that through the seller can be less expensive than attempting to qualify for a construction loan.

"Negotiating seller financing with a property that can be developed into more than one home or a place that needs significant repairs before being sold again can be a way for the buyer and the seller to share the risk," Mr. Kiefer says. "The idea is that both sides should get favorable loan terms and a repayment schedule that works for them, with clauses in the contract about how to resolve problems if anything goes wrong."

Mr. Kiefer says that on a case-by-case basis, seller financing can be a positive experience.

"For some sellers, it can be a great opportunity to get a property sold, as long as there is a tight legal agreement," Mr. Kiefer says. "For buyers, especially if they are small developers, seller financing can sometimes be their only option."