

INSIDER: Seller Financing - When You Can't Bank on the Bank

By Rachel Watson, JD, MBA Candidate

With banks applying stricter guidelines to conventional real estate mortgages, many buyers have found it difficult to qualify for home loans. It is estimated that forty percent of home loan applicants are not approved for conventional financing (Kenney 2011). With seller financing, the buyer borrows money from the seller and the seller holds the mortgage on the property. Seller financing can be beneficial to all parties in the real estate market, including buyers, sellers, and real estate professionals. Seller financing allows buyers to obtain financing through creative solutions with the seller. Sellers who offer seller financing create a larger market for their property, as buyers are not constrained by the qualification limitations of conventional financing. In *Real Estate Investing Seller Finance* (2011), Kenney suggests that real estate professionals who understand seller financing can attract a greater number of potential buyers for listed properties, craft unique solutions for their clients during negotiations, and sell properties that may not qualify for loans under conventional financing.



THINK POINT #1: Using Seller Financing Increases Financing Options

Seller financing can be used for financing an entire home loan or in combination with conventional financing. For example, if a buyer is only able to qualify for seventy percent of the purchase price of a home, seller financing could be used to finance the remaining thirty percent, or in the alternative, the buyer could choose to borrow a greater percentage from the seller. By using a combination of conventional financing and seller financing, the buyer can lower the amount that must be borrowed through conventional financing and the buyer may be able to qualify for a house she wouldn't have qualified for otherwise (Kenney 2011). Finally, by reducing the conventional financing amount to below eighty percent of the sales price, most mortgage companies will not require borrowers to carry private mortgage insurance (Kenney 2011).

THINK POINT #2: Seller Financing: A Win-Win for Buyers and Sellers

Seller financing offers numerous benefits to the buyer. Seller financing has fewer guidelines and restrictions than conventional financing, and any issues that arise between the seller and buyer

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are negotiable points. Buyers are often not approved for conventional financing due to factors such as credit issues, job interruptions, high debt-to-income ratio, or an unusual employment history; however, these challenges can be addressed through seller financing and negotiated by paying a higher sales price or higher interest rate (Kenney 2011). Closing costs can be lower with seller financing than with conventional financing because there are no loan officers to pay and buyers do not pay points on loans. Additionally, because all the terms of seller financing agreements are flexible, sellers may be more lenient regarding a down payment than in a conventional loan.

Seller financing benefits the seller as well. Because seller financing allows buyers to shop for homes that they may otherwise not have qualified for under conventional financing, the number of potential buyers is increased when seller financing is offered and homes with the option of seller financing typically sell faster (Kenney 2011). In seller financing, sellers have the opportunity to make money beyond the profits on the sale of the house. In addition to interest earned on the loan, a buyer is often willing to pay a premium for the opportunity to use seller financing, since the buyer may have been unable to obtain conventional financing (Kenney 2011). As a further benefit to sellers, conventional financing often requires the seller to perform costly renovations to the property to meet lending requirements. However, with seller financing, renovations can be negotiated between the parties to result in an agreement most beneficial to the parties. Finally, any improvements made to the property while it is owned by the buyer would increase the seller's security interest in the property should it need to be taken back in a default scenario (Kenney 2011).

THINK POINT #3: Assess the Buyer's Ability to Repay a Loan

When analyzing a potential buyer's ability to repay a loan, a seller should look at factors that a conventional bank would examine. Factors that should be considered include a buyer's past credit history, a buyer's debt load in relationship to income, and a buyer's employment history (Kenney 2011). While any one issue could be negative in isolation, it is important to remember that in seller financing, these issues are points of negotiation and could result in higher compensation to the seller in the form of a higher interest rate, a higher sales price, or a higher down payment.

THINK POINT #4: Creative Solutions Through Seller Financing

Seller financing is flexible and offers creative solutions for sellers and buyers. If a buyer does not have enough funds for a down payment, the parties could agree to either increase the sales price of the property or increase the interest rate of the loan (Kenney 2011). It is important for the seller to consider that a small bump in the interest rate can be far more beneficial to the seller over the term of the loan than an increase in sales price. For sellers that do not want to offer financing for an extended period of time, but need to keep payments manageable for buyers, balloons offer a solution that keeps payments low and gives buyers time to either pay off the note

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or refinance before it is due. Because seller financing gives a buyer time to rebuild his credit, the buyer can often refinance the balloon note when it becomes due using conventional financing. The key aspect of seller financing is that the terms are negotiable, and the parties should be creative to reach a solution that meets the goals of each party involved.

Recommended Reading

Kenney (2011), *Real Estate Investing Seller Finance*, Altoona, PA: Eiram Publishing.

About The Author

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