Safe Seller Financing - 7 Tips to Protect Sellers That Owner Finance

In an effort to stand out from the crowd, sellers are turning to owner financing. By accepting payments over time from the buyer, the seller provides an alternative to bank financing.

Why agree to “Be the Bank” and offer financing terms?

Using the phrase “Owner Financing Available” in for sale ads will attract more buyers. It gets their attention in a market flooded by oversupply from foreclosures. Buyers can avoid the expense of a bank mortgage and strict approval guidelines. In exchange, sellers can get a better sales price or sell the property quickly.

Of course sellers don’t want to jump from the frying pan into the fire by trading a house that won’t sell for a buyer that won’t pay.

Here are 7 tips for sellers considering an owner carry-back:

Tip #1 – Review the Buyer’s Credit
How buyers have paid bills in the past is a good indicator of how timely they will make future payments. Always review the buyer’s credit prior to accepting a promise to pay.

Sellers can obtain a signed authorization from the buyer to pull credit through a reporting agency, or simply ask the buyer to obtain a copy of his or her report for review. Most note investors prefer credit scores above 675. If the scores are lower it will likely reduce any offers to purchase the note after closing.

Tip #2 – Get a Down Payment
The more money a buyer puts down, the more “skin” they have in the deal. The greater the equity, the lower the likelihood the buyer will stop paying.

When people have little to no equity, they are more likely to default or just walk away from the home. Few sellers want the hassle of taking back a property through foreclosure, so increase the odds in your favor by requiring a down payment.

Tip #3 – Verify Affordibility
If a buyer can’t afford the monthly payments it soon results in late payments or worse, no payments. Buyers should be willing to share their job history along with how much money they make each month. Paycheck stubs or tax returns can help verify the income.

A common gauge of affordability is to keep the housing expense around 27-30% of income. The monthly housing expense is a combination of the principal and interest payment plus 1/12th of the annual property tax and insurance bills (known as PITI). If a buyer makes $2,000 per month than the PITI should be no more than $540 - $600 using this rule of thumb.

Tip #4 – Set Valuable Terms

The terms include interest rate, payment amount, and the due date for payment in full. There are also late fees, default clauses, requirements for insurance, and other standard provisions.

While the terms can be whatever the buyer and seller agree upon, sellers that charge 2-4% above the standard mortgage interest rate increase the value of future payments. The buyer still saves on the expensive loan fees and the seller is compensated for having to wait for payments. Charging a below market rate means the buyer is unlikely to refinance in the near future. It also results in a higher discount should the note be sold.

Tip #5 – Seek Professional Help

The legal documents are an important part of safe seller financing. They put the agreement in writing and make sure the terms can be enforced. The do it yourself approach is great for some projects but when it comes to legal documents seek the help of an attorney or title company familiar with local laws and the HUD Safe Act.

These professionals handle the closing and prepare the documents. They will likely suggest a Promissory Note for the obligation to pay with a Mortgage or Trust Deed recorded in the county records. In some states a Contract for Deed or Real Estate Contract can be an alternative option. The HUD-1 Settlement Statement itemizes the sales price and payment of closing expenses.

Tip #6 – Collect Payments Like a Pro

Collecting the monthly payments, tracking the balance, and calculating how much goes to principal and interest is often referred to as servicing the note. A third party company or servicing agent can handle this process, automatically deposit payments, and provide the annual IRS Form 1098 mortgage interest reporting.

While it's a whole lot easier to use a third party some sellers elect to collect payments on their own. This involves setting up an amortization ledger, taking a copy of the check or money order each month, and keeping the bank confirmation of deposit. To create a verifiable payment history it is best to avoid accepting payments in cash or cashing checks without first depositing.

Tip #7 – Track Taxes and Insurance

Making sure the buyer keeps taxes and insurance current is right up there with collecting timely payments. A check with the county where the property is located will verify if taxes have been paid current on their due date.

When the property includes a home or other buildings the documents should require insurance to protect against fire, hazard, or flood (if in a flood zone). The buyer can provide a copy of the insurance declaration page, showing the seller as a loss payee. A call to the insurance company when premiums are due will verify the coverage is being kept current.

Safe Seller Financing

These 7 tips for safe seller financing can help protect sellers. They also make the note payments more valuable to a note buyer. After closing, many sellers find they would prefer a lump sum of cash rather than payments over time.

We work with investors that buy real estate notes. If you would like a free no cost analysis of your note please feel free to contact our office.

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