

SELLING YOUR RENTAL?

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Owner financing can benefit both buyers and sellers. Government statistics tell us that 40% of the homes in America are owned without debt. If you are in that position and wise to sell, it might be beneficial to you to consider owner financing when selling.

Offering to sell your home with owner financing makes it easier and less expensive for a buyer to buy your home or rental unit for a buyer that will be using it as their primary dwelling. While a traditional loan might require a credit score of 620 and stable job history, owner financing can be completed in a matter of days, and not require any formal approval process. Many potential homebuyers, for whatever reason, may not qualify for traditional loan approval. If a bank would not loan to a particular borrower, why should a seller take a risk? If a bank turns down a borrower, should you also turn them down? The answer is “no,” provided you have proper down payment and collateral.

A seller who offers owner financing should require substantial cash down payment. Only by requiring the buyer to have a cash down payment can the seller be assured of protecting his investment. And the larger the down payment, the more likely it is that the loan will be paid as agreed. A 20% down payment is preferable. If the buyer stops making payments on the loan, the seller can take back the house under the foreclosure process, and gets to keep all the money received as down payment.

In addition, the seller needs to require both a note and a security deed from the borrower to secure the debt. The note is simply a personal IOU from the buyer to the seller. In contrast, the security deed posts the house itself as collateral for the debt.

This makes the property eligible for non-judicial foreclosure if the buyer fails to meet his obligations. In many states, the process of foreclosure can move very quickly, and the lender can force the sale of a property in as little as two or three months. Coupled with a substantial down payment, the threat of foreclosure is enough to protect the seller from loss in most situations. But if there is any risk whatsoever, why would a seller want to even consider owner financing? Here are some compelling reasons that a seller might appreciate:

- Any housing offering owner financing is immediately more saleable than most other home on the market. Because many potential buyers are locked out of the traditional lending market, your home is instantly more attractive.
- Substantial cash incentives at the closing table will go to either buyer or seller when traditional financing is eliminated. Typical closing costs of about 3% of the loan are often cut in half under owner financing. If a seller charges only actual closing expenses to a buyer, the house becomes even more affordable.
- Attractive yield spread between traditional cash investments and current mortgage rates make such a loan attractive at this time. For example, many sellers choose to put their sales proceeds into safe investments, such as certificates of deposit. Currently, CD's are yielding in the range of 3% - 4%. In contrast, mortgage loans could easily be placed with a safe yield of 7% to 8%.
- As another benefit, you are allowed to earn interest on your entire equity, before income taxes, if any are due. If you sold a home for cash, you may have to pay about 25% in state and federal taxes on capital gains before you could invest the remainder in an alternative investment. By selling your home under the installment sale method, you

earn high interest on the entire pre-tax loan amount, and pay tax only when the principal is received.

- Finally, a seller can protect himself against rising interest rates by restricting the duration of the loan to a relatively short time period. For example, you might sell your home or rental unit with 30-year fixed rate financing, and include a 5-year call option. That grants the right to call the loan due in full at the end of 5 years.

Owner financing is not best for everyone or every situation, obviously. But it can offer substantial benefits for the knowledgeable seller. Be sure to check with your attorney and tax advisor.

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