What is Seller Financing?

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Also known as a purchase money mortgage, seller financing is when the seller agrees to "lend" money to the buyer to purchase and close on the seller's home. "Often, sellers do this when money is tight, interest rates are high or when a buyer has difficulty qualifying for a conventional loan or meeting the purchase price," explains Lawrence Finn, CEO Owner/Broker of Coach Real Estate Associates.

Seller financing differs from a traditional loan because, unlike the lender, the seller does not actually give the buyer cash to complete the purchase. Instead, it involves issuing a credit against the purchase price of the home. The buyer executes a promissory note or trust deed in the seller's favor.

The seller may take back a second note or finance the entire purchase if he or she owns the home free and clear.

With seller financing, the buyer makes a sizeable down payment and agrees to pay the seller directly every month.

"These loans are often more flexible," Finn comments. "The interest rate on a purchase money note is negotiable, as are the other terms in a seller-financed transaction."

Understandably, most sellers are not open to making a loan for a lower return than could be invested at a more profitable rate of return elsewhere. This means that often, interest rates they charge may be higher than those on conventional loans, and the length of the loan shorter, anywhere from five to 15 years.

Because sellers, unlike conventional lenders, do not charge loan fees or points, seller-financed costs are generally less than those associated with conventional home loans. Interest rates are generally influenced by current Treasury bill and certificate of deposit rates.

"Seller financing is a viable option when the seller does not immediately need the entire cash equity they have accumulated in the home," explains Finn. This type of financing offers less rigid qualification requirements, and eliminates nearly all loan fees.

But it can be beneficial to the seller, too. In return for providing financial assistance to the buyer, the seller receives tax benefits, attracts a larger pool of potential buyers, generally completes the sale sooner, and gets good interest earnings.

"Fear of default often makes many sellers reluctant to take back a second note or finance the entire purchase," says Finn. A thorough credit check should help to dispel many of these fears, although the mortgage also allows the seller to foreclose on the property in case of default.

"The process can be very complicated. It is a good idea to consult an attorney when putting together this kind of transaction," recommends Finn.