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When a Seller Finances the Sale

By Bob Tedeschi

Home buyers in a stagnating real estate market are starting to hear a term not bandied about since the days of high interest rates: seller financing.

This practice, also known as “carry back financing,” can be a creative way to close a deal, especially between a seller who is financially stable and a buyer who is struggling to meet the requirements of a regular lender. But real estate and lending executives say that such financing also carries risks that sellers in particular should consider.

It can be a good alternative for a seller who has other assets, “so he’s not wiped out if the buyer is delinquent,” said Raymond Bershtein, a partner in Bershtein, Volpe & McKeon, a New Haven law firm with a large real estate practice. “But if this is your primary asset, and it’s the way you’re going to retire or pay for your kids’ college bills, you’ve got to be really careful.”

Walter Molony, a spokesman for the National Association of Realtors, said that seller financing was popular in the late 1970s and early 1980s, when mortgage rates were in the high teens. “Conventional financing was basically unaffordable, so seller financing was the only thing keeping the industry alive,” Mr. Molony said.

Although interest rates remain near historic lows, home prices are high enough that some buyers still struggle to save enough money for a down payment. “And you’ve got sellers that are more motivated to negotiate terms that might help the buyer,” Mr. Molony said.

Seller financing is similar to a conventional mortgage, though sellers can finance part or all of the sale price, and the interest charged can be lower than the market rate, as is typical when a seller is conveying the house to a family member, or higher than the market rate, for buyers who cannot qualify for conventional financing.

With partial financing, buyers arrange for a first mortgage as they would with any conventional purchase.

Whatever the amount the sellers finance, they assume the role of a bank, checking credit history, determining the interest rate and drafting a mortgage agreement. The sellers bear responsibility for monthly bill collections, and must also take legal action if buyers are delinquent.

But if the seller is in the second lien position, meaning behind the conventional lender, the risks can be greater. “You’re taking the chance that you’re going to get your money out of the buyer,” said James Rice, a mortgage broker in Janesville, Wis. “It’s a risk, but in some areas where you might have problems selling properties, you either do that, or you won’t be able to sell at all.”

Sellers who offer 100 percent of the financing can spare themselves the trouble of servicing the loan by contracting with an outside company to help. For example, [CircleLending](#), based in

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Boston, services loans for \$9 a month, which includes levying late-payment penalties and arranging for loan restructuring for delinquent borrowers.

Asheesh Advani, CircleLending's chief executive, said that half of the company's deals involve one relative lending to another. "They'll typically charge 2 percent below the market rate," Mr. Advani said.

There are also tax benefits, he said. In the sale of a vacation home, for instance, rather than realizing a one-time profit with a large capital-gain tax, the owner could finance the sale himself and thereby spread out the profit over the lifetime of the loan.

Last year, Kay Sullivan, a retired executive search consultant in Tucson, lent a buyer nearly all of the \$25,000 needed to buy her small vacation cabin in West Virginia, charging 10 percent interest over 10 years.

She uses CircleLending "as insulation," she said, so she does not have to become too involved with collecting payments.

But the financial risk with this deal is small, Ms. Sullivan noted. "If it were my primary residence, I don't know if I'd have done it," she said. "I'd have to do a pretty good reference check."