



Seller Financing in a High Interest Rate World

What is Seller Financing?

When a seller uses their equity “as the loan” to the buyer/borrower of their own property.

Types of Seller Financing:

- First note and trust deed (similar to a lender).
- 2nd note and trust deed (similar to a lender).
- Land sales contract – possible 30 days to recover property, no title is transferred, and nearly impossible to add a commercial second.
 - Mortgage – right of redemption (not popular).

\$ _____ CITY AND STATE WHERE EXECUTED _____ DATE _____
 _____ days months years (indicate which) after the above date, I/we, jointly and severally,
 promise to pay to the order of _____
 at (insert place payments to be made) _____
 the sum of _____ DOLLARS,
 with interest thereon at the rate of _____ percent per annum from _____ until paid. Interest shall be paid
 _____ If any payment due is not so paid, all principal and interest shall become immediately due and collectable at the option of the holder of this note.
 Any part hereof may be paid at any time.
 If this note is placed in the hands of an attorney or other third party for collection, I/we promise and agree to pay the holder's reasonable attorney fees and/or
 collection costs, even though no suit or action is filed. If a suit or action is filed, the amount of such reasonable attorney fees shall be fixed by the court(s) in which the suit
 or action, including any appeal, is tried, heard or decided.

FORM No. 216 - PROMISSORY NOTE - No Prepayment Penalty. NO

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TRUST DEED

STATE OF OREGON, }
 County of _____ } ss.

I certify that the within instrument was received for recording on _____, at _____ o'clock _____ M., and recorded in book/reel/volume No. _____ on page _____ and/or as fee/file/instrument/microfilm/reception No. _____, Records of this County.

Witness my hand and seal of County affixed.

NAME _____ TITLE _____
 By _____, Deputy.

THIS TRUST DEED, made on _____, between _____, as Grantor, _____, as Trustee, and _____, as Beneficiary,

WITNESSETH:
 Grantor irrevocably grants, bargains, sells and conveys to trustee, in trust, with power of sale, the property in _____ County, Oregon, described as:

_____ together with all and singular the tenements, hereditaments and appurtenances and all other rights thereunto belonging or in any way now or hereafter appertaining, and the rents, issues and profits thereof, and all fixtures now or hereafter attached to or used in connection with the property.

FOR THE PURPOSE OF SECURING PERFORMANCE of each agreement of grantor herein contained and payment of the sum of _____ Dollars, with interest thereon according to the terms of a promissory note of even date herewith, payable to beneficiary or order and made by grantor, the final payment of principal and interest, if not sooner paid, to be due and payable on _____.

The date of maturity of the debt secured by this instrument is the date, stated above, on which the final installment of the note becomes due and payable. Should the grantor either agree to, attempt to, or actually sell, convey, or assign all (or any part) of the property, or all (or any part) of grantor's interest in it without first obtaining the written consent or approval of the beneficiary, then, at the beneficiary's option*, all obligations secured by this instrument, irrespective of the maturity dates expressed therein, or herein, shall become immediately due and payable. The execution by grantor of an earnest money agreement** does not constitute a sale, conveyance or assignment.

To protect the security of this trust deed, grantor agrees:

- To protect, preserve and maintain the property in good condition and repair; not to remove or demolish any building or improvement thereon; and not to commit or permit any waste of the property.
- To complete or restore promptly and in good and habitable condition any building or improvement which may be constructed, damaged or destroyed thereon, and pay when due all costs incurred therefor.
- To comply with all laws, ordinances, regulations, covenants, conditions and restrictions affecting the property; if the beneficiary so requests, to join in executing such financing statements pursuant to the Uniform Commercial Code as the beneficiary may require, and to pay for filing the same in the proper public office or offices, as well as the cost of all lien searches made by filing officers or searching agencies as may be deemed desirable by the beneficiary.
- To provide and continuously maintain insurance on the buildings now or hereafter erected on the property against loss or damage by fire and other hazards, as the beneficiary may from time to time require, in an amount not less than \$_____. All policies of insurance shall be delivered to the beneficiary as soon as issued. If the grantor shall fail for any reason to procure any such insurance and to deliver the policies to the beneficiary at least fifteen days prior to the expiration of any policy of insurance now or hereafter placed on the buildings, the beneficiary may procure the same at grantor's expense. The amount collected under any fire or other insurance policy may be applied by beneficiary upon any indebtedness secured hereby and in such order as beneficiary may determine, or at option of beneficiary the entire amount so collected, or any part thereof, may be released to grantor. Such application or release shall not cure or waive any default or notice of default hereunder or invalidate any act done pursuant to such notice.
- To keep the property free from construction liens and to pay all taxes, assessments and other charges that may be levied or assessed upon or against the property before any part of such taxes, assessments and other charges becomes past due or delinquent and promptly deliver receipts therefor to beneficiary. Should the grantor fail to make payment of any taxes, assessments, insurance premiums, liens or other charges payable by grantor, either by direct payment or by providing beneficiary with funds with which to make such payment, beneficiary may, at its option, make payment thereof, and the amount so paid, with interest at the rate set forth in the note secured hereby, together with the obligations described in paragraphs 6 and 7 of this trust deed, shall be added to and become a part of the debt secured by this trust deed, without waiver of any rights arising from breach of any of the covenants hereof. For such payments, with interest as aforesaid, the property hereinbefore described, as well as the grantor, shall be bound to the same extent that they are bound for the payment of the obligation herein described. All such payments shall be immediately due and payable without notice, and the nonpayment thereof shall, at the option of the beneficiary, render all sums secured by this trust deed immediately due and payable and shall constitute a breach of this trust deed.
- To pay all costs, fees and expenses of this trust, including the cost of title search, as well as the other costs and expenses of the trustee incurred in connection with or in enforcing this obligation, and trustee and attorney fees actually incurred.
- To appear in and defend any action or proceeding purporting to affect the security rights or powers of beneficiary or trustee, and in any suit, action or proceeding in which the beneficiary or trustee may appear, including any suit for the foreclosure of this deed or any suit or action related to this instrument, including but not limited to its validity and/or enforceability, to pay all costs and expenses, including evidence of title and the beneficiary's or trustee's attorney fees. The amount of attorney fees mentioned in this paragraph in all cases shall be fixed by the trial court, and in the event of an appeal from any judgment or decree of the trial court, grantor further agrees to pay such sum as the appellate court shall adjudge reasonable as the beneficiary's or trustee's attorney fees on such appeal. It is mutually agreed that:
- In the event that any portion or all of the property shall be taken under the right of eminent domain or condemnation, beneficiary shall have the right, if it so elects, to require that all or any portion of the monies payable as compensation for such taking which are in excess of the amount required to pay all reasonable costs, expenses and attorney fees necessarily paid or incurred by grantor in such proceedings, shall be paid to beneficiary and applied by it first upon any reasonable costs and expenses and attorney fees, both in the trial and appellate courts, necessarily paid or incurred by beneficiary in such proceedings, and the balance applied upon the indebtedness secured hereby. Grantor agrees, at its own expense, to take such actions and execute such instruments as shall be necessary in obtaining such compensation promptly upon beneficiary's request.

NOTE: The Trust Deed Act provides that the trustee hereunder must be either an attorney who is an active member of the Oregon State Bar, a bank, trust company or savings and loan association authorized to do business under the laws of Oregon or the United States, a title insurance company authorized to insure title to real property of this state, its subsidiaries, affiliates, agents or branches, the United States or any agency thereof, or an escrow agent licensed under ORS 906.005 to 906.005.

*WARNING: 12 USC 1701j-3 regulates and may prohibit exercise of this option.

**The publisher suggests that such an agreement address the issue of obtaining beneficiary's consent in complete detail.

The most common ways a seller can finance or help finance a sale:

1. Sell their property using a 1st position note and trust deed or land sales contract (can be used in Oregon).
2. Carry a second position note and trust deed.
3. A “wrap around” or all-inclusive note and trust deed.

What factors motivate a seller to finance the sale?

1. Achieve a higher selling price by being flexible with down payment, interest rate, term (scenario 2).
2. Create an income stream on equity, and have it secured against their own property (scenario 3).
3. Minimize taxes by accepting principal over time versus a lump sum.
4. Only way to sell an otherwise “unloanable” property (i.e. mobile home without a foundation on land, home without foundation, building that was substantially damaged by flood, fire, wind, or a property with oil contamination that the buyer will clean up).
5. A buyer might not qualify for financing today:
 - Doctors that had a foreclosure in the last few years
 - Working couple making a great income, excellent credit, but not enough down payment
 - A buyer that can repair a house deficiency (such as put on new roof, paint, electrical, foundation, to earn down payment and then refinance.
 - Not enough time on the job in a new career
 - Rates went up so quickly they no longer can afford a home in the neighborhood they want to be in (scenario 1).
 - Time to repair, credit, and then refinance.
 - They have a trade-in item that must be a part of the sale (i.e. luxury boat, timeshare, or a contract for future work like roof, electrical, painting, essentially things a lender does not like).

Continued:

Why a seller might choose to finance a sale using one of the above security agreements:

1. They might be able to achieve a higher selling price by being flexible with the lower down payment or interest rate and term are all negotiable.
2. A property might not qualify for financing and this allows a seller to sell and move on (i.e. no foundation, extensive repairs, land locked).



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SCENARIO 1

Bradley and Betty decide to sell their 3-plex. They owe \$325k at 3.5%. Their accepted earnest money agreement is for \$950k with \$250k down and a seller carried Note and Trust Deed for \$700k at 5.5%. What is their blended total rate of return on this note? What are the obstacles to doing this?

Note: If the seller does not pay off the \$325k existing first at closing it is an "all inclusive" Note and Trust Deed.

The Math:

Accepted Earnest Money: *\$950,000*

Down Payment: *\$250,000*

Balance: *\$700,000*

Interest rate on Note: $5.5\% \times \$700,000$ *\$38,500*

But the Seller Pays: Sellers 1st $\$325,000 @ 3.5\%$ annual interest paid *\$11,375*

Net \$\$\$ After Payment: *\$27,125*

Determine how much equity is earning \$27,125 (Net \$\$\$)

$$\$700,000 - \$325,000 = \$375,000$$

$$\frac{\$27,125}{\$375,000} = 7.2\% \quad \text{Real or "blended" rate of return}$$

Another Way To Look At It:

- On the 1st of \$325k he earns 5.5% but pays out at 3.5%, so he nets a 2% override (2% x \$325k) \$6,500
- On the equity of \$375k he earns 5.5%
- Total earned: +\$20,625
- \$27,125

$$\frac{\$27,125}{\$375,000} = 7.2\% \text{ Blended rate of return}$$

Scenario 2

John and Sara's home is listed at \$725k. Their home has not had any offers, they already bought their next home and do not need all of the proceeds of the sale. In talking to their realtor Jenny, she mentioned that she has a couple that love the house but their higher interest makes them no longer eligible. Jenny called their lender Josh at Academy Mortgage and learned that if the sellers carried a 2nd note and trust deed at 3% for 5 years, they would be able to buy the home. Their first position loan with Josh would be at 6.5%.

John and Sara are trying to decide: do they carry a second at a sales price of \$725k at 3% for 5 years, or should they lower the price to \$695k in hope of getting a cash out? The home needs to be updated (carpet, paint, counters), and the buyers are happy to do the work over time.

Analysis:

- Take the cash out and have \$695k.
- Buyers put 10% down \$69,500 and borrow 90% (\$625,500)

Analysis Continued... (Alternative 2)

\$725,000	Selling Price
-\$72,500 10%	Buyer Down Payment
<u>-\$72,500 10%</u>	Seller Second at 3% for 5 years (\$181.25/month or \$2,175/year)
\$580,000	6.5% First Note and Trust Deed with Josh at Academy Mortgage

Seller can get \$725k - \$695k or \$30k more money + \$2,175 each year for five years:

$\$725,000 - \$695,000 = \$30,000$ *price difference*

$3\% \times \$72,500 \text{ 2}^{\text{nd}} = \$10,875$ ($\$2,175 \times 5$ years)

\$40,875 received by seller over 5 years

$\$40,875 / 5$ years = \$8,175/year

$\frac{\$8,175}{\$72,500} = 11.3\%$ average annual return

Average 11.3% return on this transaction yearly!!!

SCENARIO 3

Jerry and Teri are ready to retire in 2 years. Combined, they currently earn \$200k. They want to sell their rental house. Realtor Kelly sat with them and explained why they might consider selling the rental on a 1st note and trust deed vs. selling with a cash out. Kelly said they would net \$600,000 after commissions and closing costs if they sold cash out.

The math looks like this:

\$600,000	Net Sale Price
<u>-\$150,000</u>	Assumed basis for this example
\$450,000	Long Term Capital Gain in Year of Sale if held over 1 year as an investment

The \$450,000 in one time sale gain is taxed at long term capital gains rate (15-20% Federal and 9.99% State).

So use 24.99% combined

$$\$450,000 \times 24.99\% = \$112,455$$

$$\$450,000 - \$112,455 = \$337,545 \text{ NET CASH LEFT}$$

Put in money market @ 3%	\$10,126.35/year
Put in stock market?	Risk of capital loss
What is the planned use?	

Also Consider...

\$600,000 note and trust deed earning 5% for 5 years = \$30,000 year in interest only

There could be some principal in the payment – to set pay, negotiate the term: 20 year, 30 year amortization

OR

Also consider stepping the payments:

5% for 2 years – \$30,000 + \$30,000

6% for 3 years – \$36,000 -> 3 years

Total income: \$168,000

Balloon in 5 years when they retire which lowers the transaction into a lower tax bracket?

Capital Gains Tax Rates for 2023

Long Term Capital Gains Rate

Taxable Income

0%

\$0 to \$44,625

15%

\$44,626 to \$492,300

20%

\$492,301 or higher