

Coffee, Tea or Seller Financing

By Duane Montgomery, Esq.

Most buyers and sellers of property have some knowledge of the possibilities and benefits of seller financing as a means to finance the purchase and sale of property interests. But when financing is required in order to close a deal it is often considered a less desirable option than turning to traditional third-party financing resources. However, given the currently tight credit markets, buyers and sellers may want to focus more closely on the possible use of seller financing for their transactions.

Within the real estate purchase and sale context, seller financing typically involves the seller taking back “paper” from the buyer in the form of a promissory note secured by a deed of trust against the sold real estate as partial payment for the purchase price. Yet there are quite a few other seller financing devices that parties might want to utilize such as lease-options, all-inclusive trust deeds (also described as wrap-around mortgages), and installment land contracts described in the Civil Code § 2985 as “real property sales contracts.”

Lease options involve the buyer leasing the property from the seller with an option to buy the property within a designated period of time. Frequently, a portion of the lease payments are credited toward the purchase price and the buyer pays an agreed amount for the option, referred to as option consideration. Well drafted lease option contracts will also include a mechanism for determining the purchase price at the time the option to purchase is exercised.

All-inclusive trust deed transactions involve the seller taking back “paper” from the buyer, however the all-inclusive deed of trust

also includes (or wraps around) the payment obligations under the existing deed of trust against the property. The buyer then agrees to make payments based upon the aggregate amount secured by the all-inclusive deed of trust. The seller, in turn, makes the required payments to the holder of the existing deed of trust. Generally, the seller will charge a higher rate of interest on the total amount secured by the all-inclusive trust deed than the interest rate charged on the obligations secured by the existing or underlying deed of trust. Sometimes the consent of the beneficiary under the existing deed of trust will need to be obtained before entering into an all-inclusive trust deed in order to avoid triggering due on sale provisions.

An installment land contract is a contract to sell real property in which the seller retains the deed to the real property until the buyer makes payments in installments equal to the entire purchase price or as much as agreed to by the parties. But because of various court rulings treating installment land contracts as essentially a security device, the advantage to the seller of retaining the deed until the buyer makes all installment payments has for the most part disappeared. The result has been that when selecting a seller financing device the more traditional arrangement of taking back “paper” is more likely to be chosen than an installment land contract.

Besides providing needed financing in order to close a deal, there are other benefits to the seller and buyer when utilizing seller financing. To the seller there may be benefits associated with reporting income from the sale in installments rather than in a lump sum, and possibly being in a better position to negotiate a higher purchase

price in exchange for agreeing to deferred payments. Buyers may be able to avoid some of the customary third-party lender charges such as points and appraisal fees and might be able to negotiate more favorable credit terms than those generally obtained from institutional lenders.

Thus, it is possible to structure seller financing devices in a variety of ways in order to satisfy the parties’ given financing requirements. In light of the current difficulties in securing financing and the possible benefits of seller financing to buyers and sellers alike, it may be the perfect time for parties to consider how such devices might assist them in closing their transactions.

Before moving forward with a seller financing transaction involving residential real estate, the seller will want to make sure it is in compliance with or exempt from the S.A.F.E. Mortgage Licensing Act and state law requirements regarding its implementation.



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