November 2023

SELLER PURCHASE MONEY FINANCING DURING TIMES OF HIGH INTEREST RATES

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Currently, our market is experiencing substantially higher interest rates on mortgage loans, both residential and commercial. While some of the real estate professionals and investors recognize this as an adjustment, as well as, acknowledging the realities of the marketplace, many Sellers, home Buyers and investors, are concerned that these high-interest rates will preclude them from selling or acquiring properties. Currently, 30-year fixed rate residential mortgage rates are approaching eight percent (8%). Commercial lending rates currently are also hovering in the eight percent (8%) range.

EFFECT ON RESIDENTIAL PURCHASERS/BORROWERS: Given the higher interest rates, many purchasers seeking to get institutional financing realize that they are not going to be able to qualify for the needed loan due the increased monthly payment exceeding the criteria to qualify for that loan needed to purchase the specific home.

Further, since rates are based on income, some borrowers realize that the higher rates would be a real struggle to make those payments since the to the higher interest rates push the monthly principal/ interest/ taxes and insurance amount in excess of what they can actually afford even assuming a lender would be willing to extend the loan.

EFFECT ON COMMERCIAL BORROWERS: Commercial borrowers, while doing their proformas on a property, realize that such higher interest rates affect their return on investment for a project, making the project projections unfeasible.

EFFECT ON SELLERS (RESIDENTIAL OR COMMERCIAL): High interest rates are affecting residential Sellers. They are receiving fewer purchase offer or are faced with making price reductions to meet the current market. At the very least, they have to be able to compete for Buyers who need institutional financing.

For commercial property Sellers, they are experiencing some fall-off in potential commercial Buyers based upon the effect on a commercial Buyer's proforma.

The result is that homeowners are unable to acquire the home that they want due to the higher interest rates. The commercial investor must also pass on the acquisition because the financial projections with the higher interest rates make the acquisition less attractive.

The effect that this has on the Seller of the residential or commercial property is that their property will not sell or they have to consider a drop in the price or limit their sale only to cash Buyers, who may negotiate their own price discount.

Is there a solution to the situation with higher interest rates in the current marketplace? Yes, there is!

SELLER PURCHASE MONEY FINANCING:

Seller Purchase Money Financing is the concept that the Seller, as Owner of the property, finances a portion of the purchase price for the Buyer.

In this scenario, the Seller acts as a traditional lender and receives, as consideration for its property, a first mortgage for a portion of the purchase price. The Seller receives part cash and the balance in a mortgage note, with interest, and a mortgage lien against the property being sold with a mortgagee title insurance policy. The Buyer receives a statutory warranty deed obtaining title to the property with title insurance, with the exception on the title policy being the first mortgage of the Seller.

The Buyer makes monthly mortgage payments of principal and interest to the Seller and also provides that the Seller is listed as an additional insured on the home's insurance policy.

Seller Purchase Money Financing is a traditional longtime format that many real estate investors have utilized, to both sell their properties at the highest and best price, as well as, to accommodate certain Buyers who may not otherwise qualify or are able to obtain institutional financing.

Note: This article does not cover Seller purchase money financing by the use of a Contract for Deed, Agreement for Deed, Rent-to-own contract, Lease with option to purchase or other type of offerings in the marketplace. Those offerings do not transfer title to the Buyer or initially involve Seller Purchase Money Financing in the format of the issuance of a deed with mortgage financing.

Those other offerings oftentimes are used by Sellers making offers to entry level home buyers and oftentimes are violative of the Dodd Frank Act as well as dangerous for unsophisticated buyers. Caution should be used when addressing those type of offerings.

RESIDENTIAL PROPERTIES SOLD WITH SELLER PURCHASE MONEY FINANCING: On dwellings used as a primary residence by the Borrower, there are Federal restrictions that have been in place since 2014, when Purchase Money Financing is used and a Buyer intends to use the property as their primary dwelling. This restriction is the Federal Dodd-Frank Act, which in its initial draft precluded any Seller Purchase Money Financing to take place in the marketplace.

This was corrected by some amendments to Dodd-Frank which has resulted in somewhat of a patchwork format for Seller Purchase Money Financing. This article will address utilization of Seller Purchase Money Financing for: Investors, Sellers, and Buyers. It will also address the properties being purchased as an investment or to be used as a Buyer's primary residence.

The following links are the articles written on Dodd Frank that I've written as well as several other authors identifying some of the significant issues that individuals involved with Seller Purchase Money Financing need to recognize:

https://www.kfjlaw.com/wp-content/uploads/sites/2868/2016/03/Update-as-to-the-Dodd-Frank-Act-Seller-Financing-Restrictions.pdf

https://www.nar.realtor/reports/Seller-financing-impact-of-the-safe-act-and-the-dodd-frank-act

To make this somewhat simpler and address the use of Seller Purchase Money Financing we will break this down into two main categories:

- Exceptions to Dodd Frank with Seller Purchase Money Finance for Investment Property either commercial or residential.

- Application of Dodd Frank to Seller Financing for Property that is Secured by a Dwelling).

SELLER PURCHASE MONEY FINANCING FOR INVESTMENT PROPERTY—EXCEPTION TO DODD FRANK:

The Dodd-Frank Act does not apply to investment properties in which the Buyer is not going to make the property's primary residence. So, if the investment is a commercial property or if the property is residential but is being used as an investment, not the future dwelling of the new Buyer, the Dodd-Frank Act would not apply. In such cases, Seller Purchase Money Financing can be utilized without the necessity to comply with the restrictions of the Dodd-Frank Act.

By way of an example, an individual is selling a rental property in which the Buyer is going to purchase as an investment but and not as the Buyer's primary residence. In such case, the Dodd-Frank Act would not apply since this is a non-consumer Buyer, or a Buyer that is a Corporation, LLC, Land Trust or is an investor.

If the Buyer is an individual but still only intends to use this for investment, the Dodd-Frank Act in Regulation Z still does not apply since Dodd-Frank only applies to residential mortgage transactions secured by a dwelling. (Note: it is recommended in Florida not to take title to investment property in an individual's name). See the following link for an article on the use of business entities for the acquisition of investment properties: https://www.jmlawfl.com/wp-content/uploads/sites/2868/2016/03/Use-of-Business-Entities-and-Acquisition-of-Real-Estate-Investments-10.14.15.pdf

The Dodd-Frank Act also does not apply to transactions involving commercial property, vacant land, or investment property. However, caution should be given when the closing takes place, that there is a specific Dodd-Frank compliance acknowledgement signed by Seller and Buyer confirming the use is not for residential dwelling of the purchaser. That is critical for any future disputes involving the Seller or Buyer over the Purchase Money Financing.

Example of the benefit of Seller Purchase Money Financing on investment property. Using an example of the sale of a $500,000 investment property and the Buyer needs institutional financing required. Most commercial lenders will request a loan to value ratio of 75% to 80%. That means the buyer is financing $400,000 at 8% amortized over 30 years (using 8% as an approximate fixed mortgage rate for this example).

In this instance the Seller, who might not be able to obtain full purchase price on the property from a Buyer due to the high-interest rates of institutional financing since the Buyer might not be able to qualify for such loan or even if qualified could not afford the payments (see further example of effect of higher interest rate on the payment amount). However, the Seller could offer a prospective Buyer a slightly lower interest rate using Seller Purchase Money Financing while, at the same time maintaining the sale price of the property.

The Seller Purchase Money Financing will enable the Buyer to purchase the property without the necessity to pay for underwriting, origination fees, and lender fees with the Buyer paying only the standard and customary governmental documentary tax and intangible tax on a mortgage note and the preparation of the loan documents.

The Buyer gets a lower-than-market rate interest rate to enhance the sale by the Seller since the Buyer, in this case, might be able to afford a monthly payment lower than an institutional lender or simply will pay the full purchase price since the Buyer's monthly payment is lower using Seller Purchase Money Financing.

> Example with Institutional financing.: Sale of investment property at $500,000 with 80% loan institutional loan. The loan amount, $400,000, is amortized over 30 years at 8% interest which results in a monthly mortgage payment of $2,935.
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> Example with Seller Purchase Money Financing: The sale of the same investment property at $500,000 with the same 80% loan using Seller Purchase Money Financing however at a lower interest rates results in $400,000 loan amortized over 30 years at 5% interest results in a monthly mortgage payment of $2,147. This results in the Buyer having a lower monthly payment in this case a 36% difference in monthly payments.

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In the Seller Purchase Money Financing situation, the Seller would request a balloon on the principal balance at 5 years using our example.

In this Seller Purchase Money Financing Format, the Seller needs to conduct itself just as an institutional lender would: Make sure that all of the documentation for the loan is properly created and consistent with Florida law, inclusive of the aforementioned Dodd-Frank acknowledgment of non-applicability.

The Seller utilizing Seller Purchase Money Financing, as it relates to investment properties, should fundamentally make sure the legal document is correct by retaining appropriate legal counsel to draft the legal documents, as well as, documents that reflect the acknowledgement of the non-applicability of Dodd-Frank.

From a business and pragmatic standpoint, the Seller should obtain a sufficient down payment on the property to have an acceptable loan-to-value ratio and set an interest rate which is attractive to the Buyer but still provides a Seller with an appropriate rate of return. This enables a Seller to:

1. Market and sell the property at the highest and best price,
2. Take back Seller Purchase Money Financing to benefit both the Seller and Buyer and
3. Have a price and rate attractive enough to induce Buyers while giving an appropriate interest rate yield to the Seller.

In certain circumstances the Seller might be able to still offer the properties at market rate interest to a Buyer who might otherwise not qualify for the loan (the Buyer wants to make an investment but is self-employed and the institutional lender will not underwrite the loan). In this case the Seller could request market-rate interest and the Buyer would be in a position to make the investment and also save banking fees for appraisals, underwriting, origination fees etc and secure title to the property.

Those are the fundamentals for Seller Purchase Money Financing as it relates to non-consumer Buyer transactions or transactions that are not secured by mortgage on the dwelling. Seller Purchase Money Financing can be used in those situations as an additional tool to enhance the ability of the Seller to sell its property.

DODD FRANK APPLICATIONS:

The Dodd-Frank Act would come into play if the Seller owns the property and is conveying title to a Buyer who is going to be utilizing the property as their primary dwelling. In such case, the Seller needs to be in compliance with Dodd-Frank. In order to do so, Seller must meet one of the exceptions in Dodd-Frank for Seller Purchase Money Financing, generally in compliance with the One Property exception to Dood-Frank, assuming the Seller is not doing multiple Seller Purchase Money Financing projects in a twelve (12) month period. In such case, the Seller would not need to utilize the services of a loan originator (mortgage broker) and the loan can contain a balloon payment.

Most of the commentators however believe that the balloon payment should be no less than five (5) years. Specifically, in addition to that, the interest rate cannot provide negative amortization. In addition, there's going to be any adjustable interest factors involved in a loan (annual rate increases) as a future head to inflation with a rate tied to an index, those must have reasonable limits consistent with what an institutional lender might employ-- such as a cap of no more than 2% a year. There's also a Seller Purchase Money Financing exception for a Seller wanting to do Three or Less properties in the twelve-month period. In that situation, there can be:

1. No balloon payments and

2. Seller must make a good faith determination that the consumer has the ability to repay the loan which most commentators would indicate would require underwriting and a loan originator (mortgage broker) to do such research.

The details of the one property exception and three property exceptions are set forth in the article that we published: https://www.kfjlaw.com/wp-content/uploads/sites/2868/2016/03/Update-as-to-the-Dodd-Frank-Act-Seller-Financing-Restrictions.pdf

THE TAKE AWAY: Seller Purchase Money Financing is an effective tool especially in times of high interest rates in which Sellers are finding themselves having to potentially reduce the sale price to allow for certain Buyers to qualify for the loan. Seller purchase financing can be an alternative consideration to allow the Seller to:

a) Maximize the sale price on a property to obtain full market value,

b) Receive a reasonable return on the investment with security for the Seller Purchase Money Financing,

c) Expand the universe of potential buyers who might not otherwise be able to purchase the property,

d) Allows the seller to defer income tax on the gain of the sale of their investment property with the taxable gain spread out over the life of the loan.

For the Buyer/Borrower, Seller Purchase Money Financing allows them to purchase an investment property or home that they ordinarily could not qualify for or could not afford to purchase. In many circumstances, Seller Purchase Money Financing can be a win-win for both parties.

In closing, it should be recognized that Seller Purchase Money Financing has to take into consideration that in the event of the default by the purchaser, that the Seller may be required to initiate foreclosure proceedings.

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There are risk factors to consider, but starting out using a fair loan to value ratio of 80% or less, giving the Seller at least a 20% equity cushion is essential. It should be noted that, assuming proper maintenance of the property, residential properties in Florida appreciate on average 6+% per year so the equity cushion for Seller would, under normal circumstances, continue to grow to give the Seller more protection during the life of the mortgage loan.

The Seller or Seller's agent, before advertising or offering properties using Seller purchase money financing, the prospective Seller should consult with a qualified real estate attorney so the Seller understands the risks as well as the rewards for Seller Purchase Money Financing and has proper closing documents (mortgage note, mortgage and Dodd Frank compliance/disclaimer documents) to protect the Seller.

The Law Office of Jursinski and Murphy PLLC (**www.JMLawFL.com)** is available assist you in discussing Seller Purchase Money Financing as well as drafting the contract documents and the loan documents to achieve your goal and to protect your interests.

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