Unconventional Offers: Proceed with Caution

By Sam Saad, Esq. and Tina Falzarano Bajraktarevic

Real estate transactions do not always follow a traditional path. While most offers involve familiar terms such as cash or conventional financing, Realtors may occasionally receive offers that include unconventional financing arrangements or other creative terms designed to make the transaction work.

These offers can present opportunities for both buyers and sellers. However, they can also introduce additional legal, financial and contractual considerations. For Realtors, the key is not necessarily to know how to structure every creative transaction, but to recognize when an offer requires additional scrutiny and professional guidance.

Seller Financing: A Different Kind of Transaction

Seller financing, sometimes referred to as a purchase-money mortgage, occurs when the seller provides financing to the buyer rather than the buyer obtaining all the necessary financing through a traditional lender. Seller financing is great! A seller may be able to attract additional buyers who do not fit traditional lending parameters; people such as Realtors or other small business owners who don't have regular wages. The seller may also benefit from receiving interest over time. If the seller does not need the cash from the sale, Seller financing also defers income taxes due on the sale proceeds.

However, seller financing is considerably more complicated than simply agreeing upon a purchase price, down payment, interest rate and monthly payment. The transaction will involve a promissory note, mortgage and other legal documentation, as well as tax and regulatory considerations, such the one or three property rule under the Dodd-Frank Act. Federal and state laws apply depending upon the circumstances of the transaction, and failure to strictly adhere to them can cause your deal to fail.

For that reason, Realtors should be cautious about attempting to create or advise on the structure of seller financing. The parties should be encouraged to consult with qualified legal, tax and lending professionals who can determine how the transaction should be structured and documented.

Loan Assumptions: Verify Before You Promise

Another type of unconventional financing that may appear attractive to buyers is an assumable mortgage. With an assumption, the buyer may take over an existing mortgage, potentially allowing the buyer to benefit from the seller's existing interest rate. In an environment where many homeowners have existing mortgages with rates significantly below current market rates, an assumable loan can be an appealing feature. But Realtors should never assume that an existing mortgage can be transferred to a buyer. In fact, the majority of mortgages are not assumable.

Whether a loan is assumable depends upon the specific loan and the lender's requirements. The buyer may need to qualify for the loan, and the lender may need to approve the assumption. There may also be significant financial considerations if the property's purchase price exceeds the outstanding mortgage balance. Most importantly, an assumption should not be confused with an arrangement in which a buyer simply agrees to make the seller's existing mortgage payments. Those are not necessarily the same transaction and can create very different legal and financial consequences. The safest approach is straightforward: verify the loan terms and involve the appropriate lending and legal professionals before making representations to either party.

Read the Offer Beyond the Purchase Price

An unconventional offer should be evaluated based on the entire package, not simply the purchase price. For example, an offer may include seller financing, an assumption of an existing loan, unusual payment terms, a delayed payoff or another arrangement that changes the seller's risk or the buyer's obligations.

Questions that may need to be addressed include:

- What exactly is being financed?
- Who is providing the financing?
- Is lender approval required?
- What documentation will be necessary?
- What are the applicable deadlines?
- What happens if the proposed financing cannot be obtained or approved?
- What obligations remain with the seller after closing?
- What happens if the buyer defaults?

These are important questions because the financial structure of an offer can affect the certainty of closing just as significantly as the purchase price.

Know Your Role

Creative financing can place Realtors in an uncomfortable position when clients ask questions that extend beyond the scope of real estate brokerage.

A buyer may ask, “Can we structure this offer so the seller finances the purchase?”

A seller may ask, “Can the buyer just take over my mortgage?”

The appropriate response is not to reject the idea or even to opine on the created financing. Be the source of the source for information. Instead, the Realtor should recognize the need for the appropriate professional to become involved. A Realtor can facilitate communication, help the parties understand the business terms of the offer, monitor contractual deadlines and ensure that the parties are aware when additional professional guidance may be necessary. The Realtor should not, however, attempt to provide legal, tax or mortgage advice outside the scope of the Realtor's expertise and license.

Creative Does Not Mean Careless

Unconventional offers are not inherently bad offers. In fact, a creative financing arrangement may ultimately provide an excellent solution for both parties. The responsibility of the Realtor is to help the client evaluate the offer realistically, identify potential risks and ensure that the appropriate legal and tax professionals are consulted when necessary.

The more unusual the financing structure, the more important it becomes to slow down, ask questions and verify the details before the parties move forward. The best Realtor is not the one who has an immediate answer to every unusual financing question. It is the Realtor who recognizes which questions need to be answered and who is qualified to answer them.