

## Creative Financing - Is it Time?

This is a repeat of the article that I wrote a few months ago. Bay East will be sponsoring my Creative Financing Seminar on February 15, 2007 from 1:00 to 3:30 p.m. at the Bay East Conference Center. Check the website for details.

The market is a little slower, there are more homes on the market, and the buyers appear to be more apprehensive or available in fewer numbers. How can you find new buyers? During the "Mad Seller's Market" there were numerous buyers who could not compete with the multiple offers that were going on, and many dropped out of the market. They still may be viable prospects for you, even with today's higher interest rates.

### What is "Creative Financing?"

What we consider "normal" financing today, was at one time considered creative, or at least, out of the norm. For example, FHA loans in the 1950's allowed people to buy a home with as little as 3% down, with the loan guaranteed by the Federal Government. Then came private mortgage insurance (PMI), where insurance companies charged a monthly insurance premium to insure the amount of the loan in excess of 80% loan-to-value. Lenders then began avoiding PMI by offering 80-10-10 or 80-15-5 loans, with a smaller down payment and what amounted to an equity line of credit.

The reality is that the phrase "Location, location, location" is not accurate. In a hot market, homes in terrible locations sell. In slow markets, even homes in great locations can sit on the market for months. The accurate phrase should be, "Location, Price, Terms and Condition." Please note that 3 of the 4 items can be adjusted ... all but location. Do you enjoy telling your seller to "Reduce the price?" Do your sellers enjoy hearing it? It is time to look at alternatives.

### Interest Rate Buy-Down

One method of helping a buyer is to "Buy-Down" the interest rate. A buyer can reduce the interest rate that he pays at the beginning of the loan, as well as the qualifying rate, by paying a fee to the lender (giving them their interest in advance). They can pay this fee themselves, or it can be paid by a seller. In other words, it may be beneficial for a seller to pay \$10,000 in fees for the buyer rather than dropping his price by \$30,000. That kind of price drop will normally not help more buyers qualify for a loan, while a buy down will. Contact your mortgage broker for more information on buy-downs.

### Lease Options or Equity Share

These are actually alternatives where the seller either doesn't need to sell their property, or may not need all of the proceeds, but do not want to make 2 mortgage payments. Lease options and Equity Share are two methods of accomplishing that.

A Lease with an Option to purchase creates a situation where a potential buyer wants to buy, but for some reason cannot do so right away. The seller will accept a sizable deposit (Option money) for the right to purchase the property at a pre-established price. The buyer usually agrees to make payments that are in excess of the fair market rent. If the

buyer exercises his option in a timely manner, the Option money and the portion in excess of fair market rent will get applied to the buyer's down payment. If the buyer fails to exercise the option, the seller retains all of the funds paid, and the sales contract is terminated. As you can imagine, this can turn into a nightmare if the buyer cannot exercise the option. Unfortunately, that is what happens in about 95% of the cases. If you or your client is considering a lease option possibility, be sure to use the WinForms CAR contracts regarding such transactions.

Equity sharing is where you accept less than the fair market value (80-90%), in exchange for continued partial ownership in the property. For example, the buyer may be able to afford the seller's home with a 90% loan, but does not have the 10% down payment. The buyer obtains the 90% loan, all proceeds of the transaction are paid to the seller, the agents receive commission, and the seller retains 50% ownership in the equity over the 100% value. The buyer has the option of buying out the seller's interest after 3 years, and they must do so within 5 years or the property gets sold and the proceeds distributed. Even if the seller needs all of his money, a 3<sup>rd</sup> party investor could be brought in for the additional down payment under the same terms. Equity share transactions should be supported by a written contract between the buyer and the equity share partner detailing all of the terms, obligations, the remedies for default and finally details of the final distribution and determination of the buy-out amount. This is not a document found in WinForms, and you should not attempt to create one on your own.

### Seller Carry Back

Another way is to have the seller carry back a second mortgage, secured by the property. Imagine that a home is on the market for \$800,000 and just doesn't sell. The seller reduces the price to \$780K, and then to \$760K before it finally sells. If he could sell it for \$800,000 by carrying a 10% second mortgage, he is only reducing his immediate cash receipt by \$40,000, while still entitled to eventually receive full price plus interest. He also makes the property more affordable to more potential buyers. The seller could even sell the note at a discount, and receive his cash immediately, with a reduction of less than he would have with the price decrease. This form of financing requires additional Seller Financing Disclosures, which are available through WinForms.

These can be some sophisticated techniques, and you should be careful when you use them. If you want to get the market rolling again, you need to think "outside the box" of the traditional real estate agent, and become a little creative.

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