MY Place

Advertising Supplement to the Kenosha News

What is a Land Contract?

©METRO CREATIVE

J. Michael McTernan is a Kenosha real estate Attorney

By J. Michael McTernan

In a traditional sale of real estate, the buyer pays the entire purchase price at closing using his or her own money, or more often, pay a portion of the price with cash, and obtaining a loan from a bank for the balance. Title to the property is then transferred from the seller to the buyer at a closing, and if there is a loan, the lender will record a first mortgage on the property.

But what if the buyer does not have sufficient funds to pay 100% of the purchase price, and can't obtain financing from the lender? If the seller is willing to delay acceptance of the proceeds, the parties may consider entering into a transaction known as a land contract.

A land contract is a written agreement between a buyer and seller of real estate where the seller, in effect, acts as the buyer's lender.

A typical land contract includes a down payment, followed by installment payments for the balance. Typically, the parties agree to regular monthly payments with an interest rate on the outstanding balance. Unlike a typical mortgage note, which often extends for 30 years, land contracts are often much shorter – sometimes as short as 4 or 5 years. And, unlike conventional mortgage notes, which call for equal monthly payments over the term of the note, land contracts often call for relatively small monthly payments during the initial period, with the balance of the purchase price due in one final "balloon" payment, at the end of the contract. The idea behind this approach is that the buyer expects to build up equity in the property over the initial period of the agreement, and then "re-finance" the purchase with a conventional lender before the final balloon payment is due.

Under this arrangement, the buyer is able to "purchase" the house on the date the land contract is entered into, but the buyer is not the full owner of the house just yet, as legal title to the house remains in the name of the seller, who is referred to as the "vendor", until the buyer pays the entire balance. The buyer, who is referred to as the "vendee", may desire this type of arrangement as he or she may be able to negotiate a much lower down payment, and/or a better interest rate than what is otherwise available from a traditional lender, especially if the buyer's credit score is not very good.

While this type of transaction can be risky for both the buyer and seller, it does allow the seller to receive monthly payments and interest on the balance owed on the sale. The seller must make certain that the buyer takes care of the property, and insurance remains in place to insure the seller's investment is protected.

What happens if the buyer can't make that final balloon payment, or defaults on the monthly payments? With conventional financing, the lender usually sues the borrower for the balance of the note, and forecloses on the mortgage, forcing a sheriff's sale of the property.

A vendor under a land contract has more options. The vendor can force a sale, just like a conventional lender, or, vendor can sue the vendor for the unpaid purchase price without forcing a sale, or as is most common, file suit for "strict foreclosure". In strict foreclosure, the vendee is given a period of time in which to pay the entire balance of the purchase price. If the vendee is able to do so, title of the property is transferred to the buyer. If the vendee can't come up with the entire balance, the vendor gets to keep the down payment, and all of the monthly payments the vendee made, and the vendee has to surrender the property. In effect, the vendor gets the property back, and keeps all of the partial payments.

A land contract can be a great marketing tool to sell property that is unique and/or difficult for a buyer to obtain financing from a traditional lender. However, the seller must understand all of the risks that are taken on by a lender, and the buyer has to understand and accept the risks that he or she may not be able to make the final "balloon" payment. Land contracts are sophisticated transactions and should not be entered into without a thorough understanding of the associated risks and rewards.

At the risk of repeating myself...

Jeff Stevens spent years as a licensed Realtor, investor in Commercial, Residential and Industrial Property and is a freelance writer.

Hello, Kenosha home owners- anyone there? The scenario in our community is much like that of someone who is on a roll on a game show- the emotion is that of an underlying excitement- "I am going to hit the big money if I just spin one more time." Waiting when you know you are intending to sell your home carries a not too dissimilar emotion- each day that you wait may be represent that spin that says "bankrupt". It is not conservative to wait because "times are going to get better"- they might, but,even the best of experts are consistently wrong about all of this. The best time to sell is "WHEN YOU WANT TO SELL". Don't buy into the idea that listing your home and having it not sell right away will harm your marketability. Most people that look at your house are seeing it for the first time- if they are looking at it a second time,they are truly interested- they are not waiting for ghosts to come out of the closets and the plethora of secret problems to come out of the woodwork-it is simpler.

Your specific circumstances will guide the money/equity issue. If you sell your house for the present Median Sales Price in Kenosha (per Southshore Realtors) of 157,300.00 and you want to trade up, for example,to a 300,000.00 house, the equity transfer from the smaller home to the larger home does not result in a loss in equity- if appreciation in a year were 3%, the natural increase in value of the 157,300.00 home would be $4,719.00 and the natural appreciation in the 300,000.00 home would be 9,000.00 in a year's time. So, in a TRADE UP situation, why would you be waiting at all? What if you want to cash out and retire into a rental unit somewhere south? Should you wait? The answer is simple- only if you are 100% certain that waiting will make you a lot of money. Do you know anyone who is 100% certain? And, as you while away your retirement time until you are more certain, how much enjoyment will you get out of putting off your dream retirement. If you want to wait to cash out, let's analyze the numbers again- using the median sales price in Kenosha - 157,300.00.. Let's assume your home is entirely paid off-great!.. If you sell your home at 157,300.00 and your total expenses to sell run you 8% (assuming a 5% brokerage fee and 3% other seller closing costs), you will net 144,716.00 from the sale. If you wait two years and the home increases at a rate of 2.1% (zillow.com stats for Kenosha area/change in median sales price from 2015/2016), your sales price would be 163,976.00 and the net with an 8% "sales cost" would then be 150,858.00.. Seems like a pretty good choice to wait doesn't it? Seems like you just made a wise 6,142.00 just by doing nothing. But this needs further analysis- according to a recent article in U.S. News and World Report, the average cost for maintenance of a home in the US is between 1% and 45 conservatively, so your maintance cost for the two years you waited would be 3,146.00..by waiting you have made 2,996.00. Still look like a good decistion? In Kenosha, the mill rate for property taxes was 28.07 per thousand dollars of value. If you wait the two years proposed, you will have spent 8830.00 in property taxes...Now,you have lost 5,834.00 .. Still want to wait? We can add in other factors, like insurance and comparative interest by investing your money in a Jumbo CD at ".32 %".

Like I have been saying for months, Kenosha has a lot of qualified interested buyers right now. They may not be here in a year or two. The best time to sell is when you want to. Call one of the area's fine Real Estate Professionals and get off the fence.