Farm Management

Land financing options

Country Counsel
By ROBERT MOORE

A COMMON practice for buying and selling land is the land installment contract, commonly known as a land contract. In this arrangement, the purchase price is paid over a number of years instead of upfront. Sellers may opt for a land contract to spread out taxes over several years and/or to obtain a higher rate of return than what normal investments provide. The buyer may prefer a land contract if other sources of financing are not available or the seller provides an interest rate below commercial lending rates. Land contracts are commonly used but do have a few shortcomings. An alternative to a land contract is a seller-financed arrangement.

One disadvantage of a land contract is that all terms and conditions become public information. Ohio law requires the land contract to be recorded. Therefore, it can be viewed by anyone at the county recorder's office. Nothing remains private in a land contract transaction. The price, payment terms, interest rate, and other terms and conditions are public information.

Another possible issue with a land contract is transfer of the title. During the term of the contract, the seller holds the deed to the property until the buyer makes the last payment. The seller holds the "legal title" and the buyer holds the "equitable title." This concept of dual titles to the same property can create confusion and uncertainty if the buyer defaults on payments. Additionally, the seller can create big problems for the buyer if he or she refuses to sign the deed over after the last payment.

Seller-financed

Often, a seller-financed transaction is a better option to the land contract. In this type of sale and purchase, the seller is paid over a number of years in the same manner as a land contract. However, the seller initially signs over the deed to the buyer. This allows the buyer to have full, legal title to the property. The buyer signs a promissory note to the seller and grants a mortgage to the seller as security for the note. If the buyer defaults on the note, the seller can foreclose on the property and be paid the remaining balance.

Consider this example: The seller wishes to sell his farm to a buyer for $500,000. The buyer wants to buy the farm but can't obtain satisfactory financing. The seller and the buyer agree on a seller-financed approach. The buyer will make a down payment of $50,000 and pay the balance over 10 years at an interest rate of 4%. The buyer will provide the seller with a promissory note for $450,000 and a mortgage on the farm. The seller will provide the deed to the buyer upon receiving the down payment and signing of the promissory note and mortgage.

In the example, the seller is able to spread out his capital gain taxes over 10 years and receive an interest rate higher than many investments. The buyer is able to make the purchase without obtaining traditional financing and receives full, legal title to the land upfront. The seller is fully protected with the mortgage. The terms of the transaction, other than the purchase price, are kept private, as only the deed and mortgage are required to be recorded.

Sellers and buyers should consider seller-financed transactions. Using a combination of a deed, promissory note and mortgage is often a more clear and direct way of facilitating an installment sale.

Moore is an attorney with Wright and Moore Law Co. LPA
614-791-9112
rmoore@wright-law.net