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# PURCHASE MONEY MORTGAGES

In recent years many homeowners have refinanced their mortgages to take advantage of low interest rates. When interest rates rise, frequently a home buyer will want to assume the seller's existing loan, because new loans have higher interest rates and require significant closing costs. The problem is that the buyer can't always come up with the remainder of the purchase price in cash, especially if the seller's loan has been paid down or the value of the property has risen so as to create a significant amount of equity in the property. As a result, a buyer may propose that a seller take back a purchase money mortgage for the portion of the seller's equity that the buyer can't pay in cash.

There are a number of factors to consider before taking back a mortgage when you sell your home. Since your mortgage will be junior to the existing first mortgage, if the buyer defaults on the first mortgage your second mortgage can be foreclosed and extinguished. If the property doesn't yield enough money at the foreclosure sale to pay you off, you could end up losing that portion of your equity. This raises two concerns. First, make sure the buyer has good credit and can afford to make all mortgage payments. Second, make sure the buyer pays enough cash at closing so that he has some equity of his own in the property. A buyer who finances the entire purchase price frequently has no incentive to keep up the property or continue to make payments if he experiences financial difficulties.

Once you're comfortable with the buyer and the amount of the new mortgage, make sure your existing mortgage isn't due on sale and doesn't prohibit second mortgages. If that's a problem, you will need to get the lender's consent. See if your lender will agree to release you from liability at the sale. Many FHA and VA mortgages allow this if the buyer qualifies to assume the loan. If you don't get released, the lender can still hold you liable after you sell your home if the buyer doesn't make the first mortgage payments. This may affect your ability to qualify for financing if you're going to buy another home. Make sure the sales contract is conditioned on the lender giving any necessary consent and agreeing to release you if the buyer qualifies to assume the loan. If the buyer can't qualify, you should reserve the right to terminate the contract.

Consider what type of interest rate and payment schedule is appropriate. You may allow payments of interest only for a stipulated period (with a balloon payment at the end), or you may wish to amortize payments so that the buyer is paying down some principal each month. The latter is the better option if the buyer can afford it. The sales contract will need to specify exactly what the payment terms are, and should also provide some detail regarding other terms of the note and mortgage you're taking back. It should also require the buyer to pay recording fees and taxes on the mortgage, as well as the premium for a mortgage title insurance policy.

The mortgage itself should provide that any default by the buyer under the first mortgage will also be a default under your mortgage, and should give you the right to cure those defaults to protect your interest in the property, with any expenses you incur being added to the amount you're owed. It should also require you to be named as a beneficiary of the buyer's

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homeowner's insurance policy. It should have a due on sale clause, as well as a clause prohibiting any other mortgages; otherwise the buyer may sell the home to someone else who won't keep up your payments, or may pull his equity out of the property by getting another mortgage.

Most real estate brokers and office supply stores don't have comprehensive forms of purchase money notes and mortgages available. Since you may be financing a significant portion of your equity, you should have a lawyer help you draft the sales contract, as well as the note and mortgage, to address these concerns. Once you've signed the contract it may be too late.