Land Contracts Provide Financing Alternative for Some Homebuyers

Q: What is a land contract?
A: A land contract is an agreement between a buyer and seller for property that typically includes a house. It differs from other types of real estate contracts in that, under a land contract, the buyer takes possession of the property, but the seller keeps the title to the property until the buyer has fully met the contract terms.

Q: What are some of the basic requirements of a land contract in Ohio?
A: A land contract must include, among other terms, 1) the property's legal description; 2) a purchase price and down payment; 3) a requirement for annual or biannual statements of amounts paid; 4) provisions for the payment of taxes and insurance; and 5) the seller's promise to convey title when the buyer completes all payments. The land contract must be recorded with the county recorder.

Q: If I buy a property under a land contract, will there be a closing?
A: A land contract has two closings. At the first closing, you will receive possession of the property and pay the down payment to the seller. Then, you will make regular installment payments (monthly or quarterly) throughout the contract term (usually five years or less). At the end of the term, there will be a second closing. At this closing, you will make a "balloon" (larger) payment of the balance of the purchase price and the seller will transfer the title of the property to you with a deed. You will probably get a conventional mortgage to make the balloon payment, but with several years to improve your credit and increase your equity in the property, your chances of qualifying for the loan likely will have improved.

Q: How might a land contract help me as a buyer?
A: If you have poor credit or not enough funds for a down payment, a land contract functions as a form of seller financing. With a willing seller, a land contract will likely be easier to obtain than a traditional mortgage. Also, since land contracts do not involve third parties (such as a lender), you can avoid certain costs and requirements associated with a bank mortgage, such as appraisals and credit underwriting.

Q: How is a land contract advantageous to a seller?
A: A land contract may allow for a quicker sale and lower associated costs. Also, the property may attract a broader range of buyers, including many who might have trouble qualifying for a traditional mortgage, but would have sufficient funds and income to buy a home. Furthermore, because the seller is taking some risk in financing the property, the land contract property may be able to attract a higher purchase price.

Q: What if the seller's property has a mortgage?
A: If the seller's property is mortgaged, the lender's consent will likely be necessary before the land contract is executed. Many lenders will approve a land contract sale, but may require the buyer to make the installment payments directly to the lender. This ensures that the lender will receive monthly mortgage payments, which benefits the buyer by making foreclosure of the mortgage unlikely. In such a case, however, the lender will still hold the seller liable for payments if the buyer defaults.

Q: What happens if I don't keep up my payments to the seller?
A: Depending on the provisions of the contract, if you miss a payment, but become current within 30 days, you will likely not risk loss of the property or further penalty. However, if you do not become current with your payments within the 30-day period, the seller may start a forfeiture action against you. The seller must give you written notice before starting a forfeiture action, and you would then have 10 days to completely perform your contract obligations, including payment of the full remaining balance of the purchase price. If you continue to dishonor the contract, the seller can begin an eviction action or a foreclosure action. The seller can try to evict you if the contract has been in effect for less than five years and you have paid less than 20 percent of the purchase price. The seller may try to recover possession of the property through a foreclosure action if the contract has been in effect for five years or more and you have paid more than 20 percent of the purchase price.

Q: What happens if the seller defaults?
A: If you, as the buyer, have fully performed under the contract, you may file an "equitable action for specific performance" to force the seller to turn over the property deed to you. You may, alternatively, seek to cancel the contract and try to recover the purchase price that you already paid to the seller. If you do recover the purchase price, however, you may have to pay the seller an amount equal to what you would otherwise have paid in rent for the amount of time you occupied the property.

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This "Law You Can Use" column was provided by the Ohio State Bar Association (OSBA). It was prepared by Geoffrey S. Goss, an attorney with the Cleveland firm of Walter & Haverfield LLP.