Owner Financing –

Avoid 5 Balloon Mortgage Pitfalls

Using a balloon payment with owner financing can be a valuable addition to a mortgage note or land contract.

Unfortunately many sellers and buyers unknowingly combine a balloon payment with high risk factors turning a positive into a negative. Be sure to avoid these common pitfalls when considering seller financing with balloon mortgages.

1. **Extremely Short Term** – A balloon payment due less than three years from the date of sale can be viewed as a negative. The buyer needs sufficient amount of time to address and fix any issues that might have disqualified them from a traditional home mortgage loan at closing.
2. **No Down Payment** – When a buyer purchases property with a low or zero down payment they have little to no equity. When it comes time for the buyer to refinance in order to make the balloon payment it will be difficult to find a lender willing to extend a mortgage without equity in the property.
3. **Interest Only Payments** –There are no reductions to the principal balance with the use of interest only payments. Since the principal balance remains the same the buyer is not building equity, unless the property appreciates. It is better to base the monthly payment on a 20 to 30 year amortization with a balloon date than to use interest only payments. This allows the buyer to build equity and also become comfortable with a monthly payment that will more closely match what a lender will require.
4. **Poor Buyer Credit** – If the buyer has extremely poor credit it may take 7 to 10 years for them to rebuild their rating. Be realistic in the amount of time the buyer will need to build a score and credit history that will qualify for bank refinancing.
5. **Hard to Finance Property** – When owner financing is used to compensate for a hard to finance property determine how likely that is to change. For example it won't be any easier to refinance an old mobile home or a large tract of land in five years than it is today. If a property will remain difficult to finance through conventional banks then consider a fully amortizing repayment schedule based on a shorter term.

These risk factors will generally make it harder for buyers to refinance when the balloon comes due making delinquency or foreclosure more likely for the note seller or note buyer:

While balloon payments can provide flexibility and increase the value to note buyers they should not be combined with multiple high risk factors.

As a note buyer it is not uncommon to see a balloon note that has a zero down payment, interest only payments, and poor buyer credit on a hard to finance property. Not only will it be next to impossible for the buyer to refinance, it will likely turn into a delinquency or foreclosure when the balloon payment comes due.

Set the transaction up for success by avoiding the five common pitfalls of owner financed balloon mortgages.