INVESTOR SERIES

TOP TEN TIPS

Vendor Finance

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1. Instalment sales

This is where the owner (the seller or the vendor) sells the property under a 'Contract for Sale' and finances the deal themselves, instead of the buyer needing to look for bank finance. It is very much like a bank loan. The term is usually 25 or 30 years, the repayments are principal and interest, and the purchaser can pay out the finance at any time by refinancing or by selling the property. The interest rate is generally 2% p.a. above the bank rate.

The advantages are that the purchaser can move in immediately after the contract is entered into, and is able to make improvements to the property to build up their equity.

This form of vendor finance is also known as a 'WRAP', because the payment terms the owner provides, mirror the terms of the owner's own mortgage, and because the owner is permitted to maintain their own mortgage over the property.

2. Rent to own (lease options)

This is where the seller rents to a buyer for a predetermined time, and the buyer then can either buy or walk away. It is a 'try before you buy' because the purchaser is not committed to buy. Rent to own is like a rental, but has some attractions for both landlord and tenant. Firstly, the property is rented for usually 2 years, which is in contrast to a standard residential lease which is usually for 6 months.

The rent is also fixed for the term of the lease. Another attraction is that the purchase price of the property is fixed up front – there is no formula for increasing the price. The purchaser can also improve the property, to make it more pleasant to live in, and to make it easier to obtain the finance to purchase the property at the end of the agreed period.

3. Deposit finance

‘Deposit finance’ is when a vendor finances a deposit, or a shortfall between the amount of loan that an outside lender will advance, the cash deposit available and the purchase price of a property. An example, is when a lender might approve a loan of 80% of the price, and the purchaser might only have 5% deposit, and so the second mortgage carry-back finance will be 15%. It is called a second mortgage, because it ranks second in line to the first mortgage that the 80% lender takes over the title to the property. It is called a second mortgage carry-back because the vendor carries it back, which is to say, finances that part of the price.

The Deposit Finance is usually put into place for a fixed term of 2 to 5 years, and is usually interest only at the same interest rate charged by the external financier, payable monthly, and the interest rate payable is usually fixed.

At the end of the fixed term, the Deposit Finance is usually paid out from savings or refinancing, as a lump sum payment.

4. Sandwich lease

A 'sandwich lease' is where you are both the buyer and the seller for the one deal. Often a seller will be hurting for some reason. It may just be a flat market. It may be badly presented. Whatever the reason, the property is slow to sell and the seller may be experiencing financial difficulties such as job loss, negative gearing pain, illness or financial hardship of some description.

These sellers are an ideal candidate for negotiating a vendor finance deal of some description. The best type of vendor finance deal for a sandwich lease is a lease option, where a small amount of money is transferred to the seller up front (e.g. $5,000 to $10,000) and an option to purchase the property at an agreed price and time in the future is signed.

You then take over the existing owner's repayment obligations, and outgoings on the property such as rates, insurance etc. The current seller of the property moves on and he is out of the picture.

Usually when someone is having difficulties selling a property or keeping up with repayments, they don't keep up with the repairs and maintenance. Consequently, your newly acquired lease option property will need a renovation before representing it to the market. You would then do a renovation and present the property as you would for any normal sale or re-valuation process. Do not over capitalise and take the property to the standard of surrounding well-presented properties.

This is where you will need to be the seller and find a buyer for your newly acquired sandwich lease property. The ideal buyer of the property is someone who is experiencing bank, or financing difficulties, or someone with low savings, who needs more help than a normal buy to purchase a property.

Ask them to pay an upfront fee when entering the agreement (make sure it is more than you had to pay to the original owner). You will then become the financier in the deal, and the terms and conditions need to be such that whatever commitment you have made to the previous owner on repayments is covered. You lease option a seller, you lease option a buyer, make an ongoing positive cash flow on the margin between the two lease options, plus a profit on the difference between the upfront fee you pay the seller and the upfront fee you receive from the buyer.

5. Joint ventures

'Joint ventures' are a little bit like US legislation. Whatever the two parties agree on, is law, without government intervention or regulation. Unlike Australia where everything is over regulated and a deal is only a deal between two parties it if complies with council, state and federal legislation along with as much red tape as they can find.

One thing I need to stress is the need to have your joint venture agreement written, signed, and preferably formalised by a lawyer, prior to the commencement of the deal.

What I recommend you do, is sit down and discuss all possible outcomes. Ask yourselves the 'What if?' Questions and document your answers.

- **What if it doesn't sell?**
- **What if we run out of money?**
- **What if someone dies?**
- **What if someone gets divorced?**
- **What if someone gets sued?**
- **What if we don't agree on something?**
- **What if we make a loss?**

When you have thought of everything that is a potential outcome from a JV and you have both signed the document, take it to a lawyer and have it drawn up formally. This protects both parties and minimises misunderstandings and miscommunications.

6. Spotter's fees for vendor finance deals

If you've got the gift of the gab, negotiating vendor finance deals is a relatively easy way to pick up a few bucks. Many people would love to be able to do vendor finance deals, as they don't require much, or any of your own funds to make the deal happen. All you need is to be good for a loan. The reality is that very few people have the personality to complete this strategy successfully.

Obviously, if you are someone who is good at sales, a good people person, able to relate well with others, or just purely determined, then negotiating deals on vendor terms is a great way to create cash flow for yourself. If you are unable to gain banking finance because of a bad credit history, it is the perfect deal to pass onto someone else for a spotter's fee. Everyone wants to do a no-money down deal. Few people have the confidence to be able to negotiate them. Consequently, even if you are a bankrupt, you can make good money finding and negotiating this kind of deal, and then passing them on to fellow investors. You certainly won't have a shortage of people wanting to do the deals.

A typical spotter's fee has been arbitrarily set at $5,000. Of course, if you plan to do this a little more professionally, you need to be licensed, and do a real estate sales course which varies depending on the state.

A lot of the time, doing a successful vendor finance deal, is having the guts to ask, and being able to think on your feet, to work out what kind of deal will truly benefit both parties.

7. Vendor finance from a buyer's perspective

As an investor, understanding vendor finance from the buyer's perspective can help you understand the whole process of vendor finance, and realise why it can be a win/win situation for the investor and the buyer.

Vendor Finance is often the first step on the path to home ownership. The buyer who chooses vendor finance is usually looking for a home to live in, but can also be a business looking to buy a shop, factory or office for business.

When you buy your house, you'll receive a Contract of Sale that includes additional information about your loan repayments. You will receive regular statements showing your payment history, which may assist you in refinancing with another lender, which you are entitled to do at any time, and recommended to do within the 5 year timeframe.

As a buyer, think through each one of the topics below:

- **Affordability**
- **Refinancing**
- **How to get equity**
- **Deposit required**
- **First Home Owner's Grant.**
- **Who pays the outgoings?**
- **Can I make extra payments?**
- **Process of making repayments?**
- **Legal contract and advice.**

8. Vendor finance from a vendor's perspective

Recently, vendor finance has become popular in Australia not only as a way of selling properties at a good price, but also as an attractive real estate investment strategy. The seller who chooses vendor finance is usually looking to sell their property for a better price than they are able to sell the property using the standard cash sale. Selling on terms therefore provides a better outcome than selling for cash.

'Selling for cash' means the sale of a property in the standard way, with a deposit of 10% of the price payable at the time the 'Contract for Sale' is entered into; then waiting 30/42/60/90 days (depending in which part of the country the property is situated); until the remaining 90% of the price is paid – from bank finance. The sale is therefore conditional upon bank finance.

'Selling on terms' means the sale of the property on vendor finance terms, where the seller can mould the terms of the sale to fit in with the buyer's needs. The vendor finance terms are set by the seller to suit the seller's needs, as well as the buyer's needs. Significantly, the sale is not dependent upon bank finance.

In short, by using vendor finance, a seller receives two benefits; the first is that the seller sells the property more quickly than if offered at a cash price because the property is attractive to more buyers; the second is that the price does not need to be discounted for a quick sale, because terms are being offered.

9. Desperate seller

I love doing desperate vendor deals, not because you are ripping the other person off, but you genuinely are helping the other party out, and creating the ultimate win/win deal.

1. **Target uneducated sellers who are not maximising their capacity for gaining full value on the sale of their properties**
2. **Identify what strategy would create maximum profit for the seller (and you), in the most efficient timeframe.**
3. **Do a draft feasibility of your potential costs, and profits on the deal**
4. **Contact the seller directly and negotiate a mutually beneficial deal**
5. **Sign either a handwritten or pre-prepared 'Memorandum of Understanding'**
6. **Engage lawyers to draw up the final document.**

Go for a drive in your local area, and find a property that has been on the market for a while, and where you can easily see the reasons for the property not selling. Note the address of the property, and go home and research to find out who the seller is, how much the list price is, whether the agent is competent or not, and do a mini feasibility study on what strategy could be implemented to improve the property's sale price.

Determine if there is enough margin for you to warrant doing a JV deal with the seller.

10. Joint venture structures

There are three main ways in which a Joint Venture can come together:

1. **Equal party contributions**
2. **Unequal party contributions**
3. **Money partner and worker**

Equal party contributions – This is where both parties are either contributing equal amounts of money and are both included in the loan documents.

There are two main ways that this type of arrangement can be structured. The first is a partnership of two discretionary trusts. Each would have a corporate trustee and the property would be owned as tenants-in-common between the two trusts. This would allow for fractional ownership as well as 50/50 deals, as the tenants-in-common ownership can be split in any percentage.

Unequal party contributions - These can be done as tenants-in-common using a partnership of two discretionary trusts. Alternatively, a unit trust can be formed with a corporate trustee, with the units held in discretionary trusts.

This type of structure can have a few Capital Gains Tax problems, as they are treated as fixed trusts and may not be entitled to the 50% exemption for owning a property for more than 12 months. Alternatively, the trust could be a hybrid trust which would eliminate any CGT issues. However, hybrid trusts can be difficult to finance.

Percentage ownership can be distributed in whatever proportions are agreed upon between the 'piggy bank trusts'.

Money partner and the worker – In this scenario, the money partner would not need the worker partner on title or on the loan in order to buy the property. If this was the situation, the money partner would form a corporate trustee with a discretionary trust and the trust would own the property. The money partner would be named as the primary beneficiary and the appointor, and the director of the corporate trustee.

A contract would then be drawn up between the company as trustee for the discretionary trust, with the worker's personal company as trustee for a discretionary trust. The worker's trust would be protected by contract which would outline the duties and responsibilities of each party, and the agreed upon distribution of profits.

To find out more **call (03) 9490 8888** now or go to **www.iloverealestate.tv** to register for our next **FREE Webcast** where you'll discover the strategies, techniques, structures and support you need to successfully invest and prosper from Australian real estate.

Yours in success,

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