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Seller Financing – Important Considerations

by Thomas B. McCowan, Esq.

Sometimes a Seller of property is asked to "Seller-finance" or "Owner-finance" the purchase of the property by the Buyer. My Firm is often asked to draft the documents for these transactions. I find that many parties misunderstand the documentation and what happens if the Buyer defaults on the loan. The most significant misconception is that the Seller in some easy, quick, inexpensive way, just "gets back" the property. Unfortunately, Maine law makes it more difficult.

The Documentation:

In the traditional Seller-financed transaction, the Seller deeds the property to the Buyer at Closing, the Buyer signs a Promissory Note to the Seller, and the Buyer grants a Mortgage of the property back to the Seller, which is recorded in the Registry of Deeds right after the Deed. The Note is the Buyer's personal promise to pay back the Seller at the specified interest rate, term, and frequency of payment. The Mortgage lets the Seller hold the property as collateral and foreclose on the property if the Buyer fails to pay as specified in the Note. The Mortgage also requires the Buyer to pay the property taxes, keep the property insured, keep the property reasonably well-maintained, and prohibits the Buyer from conveying any part of it to anyone else without the Seller's agreement.

What Happens When It Goes Wrong:

For the Seller, the likelihood of being able to collect money from a Buyer who has failed to pay on the Promissory Note is very low. Therefore, the Seller's only hope of recovery is to pursue foreclosure of the Mortgage. In Maine, the only way to foreclose is by a civil lawsuit. There used to be other non-judicial ways, but all of them have been eliminated over the last 25 years.

What happens next is the part that many people misunderstand. Sellers often express a belief that if the Buyer defaults the property "will go back to the Seller", that the Seller "gets the property back", or that they can "take the property back." Maine laws on foreclosure make it much more complicated than that.

By law, the only way a Seller (who is called the "Mortgagee" once the Mortgage is granted back to them) can foreclose on the real estate is to give a series of notices of default to the Buyer (Mortgagor), with specified waiting periods after each. That is followed by the requirement of filing a foreclosure lawsuit in court. That lawsuit also has several waiting periods for Mortgagor response, mandatory notices, and sometimes mandatory mediation. Often there a delays in getting court dates for the necessary hearings or for trial due to busy courts. Even if the Mortgagor does not offer any defense and the Mortgagee (Seller) gets a Foreclosure Judgment

against the Mortgagor, there is another waiting period of 90 days, called the Redemption Period. During that period, the Buyer still has the right to pay off the loan, including all the Seller's attorney fees and court costs, if they are able to.

Following the Redemption Period, the Mortgagee is obligated to advertise in a newspaper for three weeks that there will be a public auction of the mortgaged real estate. Then the auction has to be conducted, usually by the foreclosure attorney or an auctioneer. At the auction, the Mortgagee's only option is to bid like anybody else. The Mortgagee's bid is usually the amount of principal, interest, late fees, attorney's fees, and court costs owed to the Mortgagee (Seller) at that moment.

If any member of the public appears at the auction and outbids the Mortgagee, they get the property. The Mortgagee gets only the amount of money necessary to satisfy the remaining loan balance, plus interest, attorney's fees, and costs of foreclosure. Any additional amount must be paid to other mortgagees and lienholders of the Mortgagor, or to the Mortgagor if there are none.

If nobody else appears and bids, then the Seller/Mortgagee wins the auction and essentially "buys" the property from themselves as the foreclosing Mortgagee. At last, the Seller has ownership of the property, free and clear of liens (if the foreclosure was done right), and can keep or re-sell it as desired. But in this scenario the Seller is never compensated for their lost attorney's fees, court costs, time, and aggravation, as well as any problems with the condition of the property.

This is a far cry from the property "just going back to the Seller". A Seller/Mortgagee should be prepared for 9 months to a year of foreclosure and court procedure, and more than $3,000 of attorney's fees*, even when the Buyer/Mortgagee doesn't defend themselves in the suit. If the Mortgagee mounts a defense or files Bankruptcy before or during foreclosure, these expenses and delays can increase dramatically.

(*Yes, you will need a lawyer. Foreclosure procedure is so complex, and the courts are so strict about compliance with the details, that you will need a lawyer to handle the foreclosure notice process and lawsuit for you.)

Additional Considerations:

1) "Deed In Lieu Of Foreclosure": Sometimes there can be a shortcut that avoids the foreclosure process, but only if the Buyer cooperates. A "Deed in Lieu of Foreclosure", conveying the property back to the Seller can be done if the Buyer agrees. That has the effect of restoring title to the Seller and extinguishing the Mortgage. However, it is VERY important to do a title search on the property before accepting such a resolution. That is to make sure there are no pending subordinate mortgages or liens against the Buyer recorded after the Seller's Mortgage. If the Seller takes back the property while there are other mortgages or liens against the Buyer, those follow the property and the Seller's title is encumbered until those liens are paid and discharged.

2) Land Installment Contracts; Bond For Deed; Lease With Option To Purchase: Some people try to do a "Bond for Deed", now known as a Land Installment Contract, or a Lease with Option to Purchase, in an attempt to get around the cost, delay, and expense of foreclosure procedures. Bad news – the legislature and Maine courts made it mandatory that these types of arrangements are all subject to the same foreclosure requirements as Mortgages when the Buyer defaults.

3) Zero Interest/No Interest Loans Not Recognized by I.R.S.: Often, Sellers who are selling to family or friends want to give the Buyer time to pay without charging any interest. Unfortunately, the U.S. Internal Revenue Service does not recognize that people want to be that friendly. The IRS assumes this to be fraud or cheating on income tax in some way. Therefore, under the tax code, the IRS forces an "Applicable Federal Rate" onto the transaction and taxes the Seller on the interest income the Seller *would have made* at that rate, even if it was not actually collected by the Seller. That Applicable Federal Rate (AFR) is published monthly by IRS, with differing rates for short-, medium-, and long-term loans. For example, the AFR for long-term loans originated in February 2026 was 4.70% per annum. It is usually best to go ahead and use the AFR as the minimum rate in the Promissory Note so that the Seller is both made aware they need to report the interest income on their taxes and the Seller has been paid the money from which to satisfy those taxes. So, a Seller can make a zero-interest loan…if they're willing to absorb the income tax hit. Sellers should consult with their accountant about what to do.

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This explanation of Seller financing is ***applicable only in Maine*** and is focused on private loans between individuals. If the Buyer is an LLC or corporation and the property is non-residential, there is the possibility of a "Statutory Power of Sale" or "Corporate Power of Sale" mortgage, which offers a shorter, non-judicial foreclosure option, but that is beyond the scope of this article.

If you have further questions about this topic, be sure to speak to your lawyer. If we are working with you, please give us a call at (207) 872-0112.

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