Contract for Deed

The Office of the
Minnesota Attorney General
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What is a Contract for Deed?

A contract for deed is a purchase contract for real estate. It may allow people who do not qualify for a traditional mortgage or who do not want to take out a mortgage to buy a house. A contract for deed means that instead of paying the seller all at once, you buy the house over a period of time, like 3-5 years. Some people think of contracts for deed as similar to a "rent-to-own" agreement.

How is it Different Than a Mortgage or Lease?

A contract for deed gives less protections to the home buyer; it is neither a mortgage nor a lease so the contract for deed home buyer does not have the same rights or protections as with a mortgage, but is also not a tenant. The buyer makes payments directly to the contract seller instead of mortgage payments to a traditional lender, and the buyer does not own the home until the full amount is paid to the seller. If the buyer is unable to complete the contract, the seller can cancel the contract, <u>with the buyer losing everything they have invested in the property</u>. At that point, if the buyer does not move out, the seller may evict the buyer.

Contracts for deed are riskier than mortgages. With a mortgage, companies must be licensed to operate and are required to follow laws that protect a borrower's rights. If a borrower falls behind on a mortgage, the mortgage companies may have internal programs to help the person get caught up. Removing a person from a property in the foreclosure process is something that can take several months or even years. A contract for deed seller does not face that level of regulation, nor does it have any obligations to assist you if you fall behind.

Another concern with contracts for deed is that since the seller maintains the title, there is a risk that if the seller has a mortgage, they might default on the mortgage, and the property could enter foreclosure even if the buyer has made all of their payments.

What are the Dangers of a Contract for Deed?

Most contracts for deed contain a "balloon payment" at the end of the contract period. This requires the buyer to pay a large amount at the end of the contract.   The balloon payments are often so large that the buyer has to take out a traditional mortgage from a bank to make the balloon payment. If the buyer does not qualify for a mortgage or does not want to take out a mortgage, then the buyer may lose the house and all money paid for it. And because homes are sometimes sold at inflated prices under contracts for deed it can be difficult for the buyer to qualify for a mortgage even if the buyer's credit score is good enough to get a mortgage. Note that contract for deed payments are not reported to credit reporting companies and will not improve the buyer's credit score.

Signing a Contract for Deed – What to Know

Before signing a contract for deed, it is important to understand the contract, and what your rights and responsibilities are. Affordability, your total costs per month, repair responsibilities, property taxes, insurance, and any other factors should be understood before you sign. Some of the things you may want to look for include:

- Check that the seller has paid the home's property taxes, and ensure that the home is not in foreclosure.
- Get an appraisal of the home along with an inspection to make sure you are not overpaying for the home.

- Understand that you will be responsible for the costs of repairs, property taxes, and general upkeep of the home once the contract is signed.
- Know what the interest rate you are being charged by the seller is, and check rates with lenders to see if the rate being offered is competitive.
- Make sure that the contract is recorded with the county recorder's office within four months of signing. Recording the contract may give you more protections.

A purchase agreement is often used by a prospective homebuyer to make an offer to purchase a home and lay out the terms of that offer. If the seller accepts that offer, the conditions spelled out in the purchase agreement are binding and will form the basis of the final contract for deed selling the home.

Home sellers are required to make certain written legal disclosures under Minnesota Statute sections 513.52-513.60. If a contract for deed is used to sell the home, additional disclosures about the transaction are required, pursuant to Minnesota Statute section 559.202. During the 5 days after the disclosures are received, the buyer may back out of the transaction and receive all of their money back by cancelling the purchase agreement.

What Happens if You Fall Behind on Payments or Cannot Afford the Balloon Payment?

After a buyer has signed the contract for deed, the buyer is responsible for making payments and for anything else agreed to in the contract. If a buyer is not able to make payments, the seller can cancel the contract. A buyer can stop the cancelation if they are able to get the money needed to catch up on payments or cure the default within the 60-day cancellation period. If the purchaser is unable to catch up in 60 days, they may be evicted. The buyer will not be able to recover any payments that they made or equity generated in the home.

Look Out for Scammers!

Real estate scammers sell a contract for deed for a home that is already in foreclosure and collect payments that they will simply pocket. Eventually the mortgage company will take the house back and the buyer will be evicted. It is important to check with the county tax office and recorder's office to see what other liens may be recorded on the property and to see if there are back taxes owed before entering into a contract for deed.

If you have any questions regarding the contract, you may wish to reach out to a real estate attorney. Please see our "Hiring an Attorney" publication for more information.

Manufactured homes are sometimes sold on contracts for deed. Please see our "Manufactured Home Parks" Handbook for more information.

For additional resources or information on contracts for deed, you can contact the Minnesota Homeownership Center (651-659-9336).

This document is available in alternative formats to individuals with disabilities by calling
(651) 296-3353 (Twin Cities Calling Area), (800) 657-3787 (Outside the Twin Cities), or through the Minnesota Relay Service at (800) 627-3529.

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