



## Frequently Asked Questions on Contracts for Deed in Minnesota

**Q: What is a contract for deed?**

A: A contract for deed lets buyers purchase land without a mortgage loan. When a buyer and seller sign a contract for deed or contract for sale, the buyer agrees to pay the sale price to the seller in installments. Unlike when a loan with a mortgage agreement is used to purchase land, the seller retains the deed—the document that transfers title ownership—until the buyer has fulfilled the contract by making the final payment. Contracts for deed are chiefly used for sales between family members or private individuals.

Farmers use both contracts for deed and mortgage loans to buy farmland. However, when a lender is involved (such as a bank or a government agency), mortgage loans are usually used instead of contracts for deed.

**Q: Is buying farmland with a contract for deed the same as buying farmland by getting a mortgage loan from the bank or the USDA Farm Service Agency (FSA)?**

A: No. Contracts for deed are private agreements between two parties. For example, a beginning farmer (the buyer) and a transitioning farmer (the seller) could enter into a contract for deed agreement. Generally, there is no bank or government agency involved in a contract for deed. Instead, the buyer makes regular payments directly to the seller according to the contract.

One important feature of contracts for deed is that the **seller keeps legal title** to the land until the full contract for deed price is paid. Since most contracts for deed require regular payments over many years, **contract for deed buyers will not actually own the property until many years after signing the contract for deed.**

Unlike with contracts for deed, when a mortgage loan is involved **the buyer acquires legal title to the land immediately:** the buyer borrows money from a lender, such as a bank or FSA, and ownership of the land is transferred to the buyer when the loan proceeds are used to pay the seller.

**Q: Why would a beginning farmer want to buy farmland via a contract for deed?**

A: A contract for deed may be cheaper or more accessible for a beginning farmer. In fact, some beginning farmers may not qualify for a mortgage loan through a bank or FSA, making a contract for deed one of their only options for purchasing farmland.

Also, down payments and interest rates for contracts for deed may be lower than for mortgage loans because contracts for deed offer certain tax advantages for the seller (see below). In addition, contract for deed sellers don't charge the mortgage origination fees and application costs that lenders often charge.

**Q: Why would a transitioning farmer want to sell farmland via a contract for deed?**

**A:** From a financial perspective, contracts for deed offer potential tax advantages. Although the effect on any individual's taxes can vary greatly, many sellers can gain a significant tax advantage because the income from the land sale is spread out over time rather than coming in one lump sum (as it would when the sale is made using a mortgage loan).

From an altruistic and/or stewardship perspective, contracts for deed can offer transitioning farmers the opportunity to help a beginning farmer acquire farmland that the beginning farmer otherwise couldn't access due to lack of capital or poor credit. That beginning farmer might be a family member, a family friend, or simply someone who shares a transitioning farmer's views on land stewardship.

Additionally, contracts for deed can be simpler for transitioning farmer sellers. There would likely be no need for a realtor, no wait for mortgage approval, and possibly no need for a formal appraisal. On the flip side, however, contracts for deed create ongoing responsibilities for sellers (see below).

**Q: What are some risks associated with contracts for deed?**

**A:** For **buyers**, a major risk is the risk of **losing money already paid if a contract for deed is canceled**—for failure to make payments or for any other reason. If these payments had been in the form of mortgage payments to a lender, such as a bank or FSA, the value of these payments may be recoverable in the form of equity if the buyer is able to sell all or part of the property before a mortgage foreclosure occurs, or if the lender is able to sell the property for more than what is currently owed on the mortgage during a foreclosure sale. In a contract for deed scenario, on the other hand, cancellation could mean the buyer loses all of the money paid through the date of cancellation (almost as if the buyer had been making rent payments instead of contract for deed payments). This is a big risk, especially in a long-term situation where a contract for deed buyer could have been making payments for 25 years on a 30-year contract for deed, and suddenly the buyer is left with no equity in the land after making payments for a quarter century.

Note that there are some potential legal avenues for recovering the value of contract for deed payments under Minnesota law, but these avenues are less straightforward than a mortgage situation and would almost certainly require a buyer to hire and pay an attorney. Note also that buyers can preserve their contract for deed rights after a default for failure to make payments as scheduled by

bringing payments current within the time period provided by state law. Under Minnesota law, for contracts for deed executed after July 31, 1985, buyers have 60 days to eliminate the default and reinstate the contract.

A second risk for buyers is that a contract for deed can be canceled more quickly than a mortgage can be foreclosed. The buyer may only have 60 days from the notice of cancellation of a contract for deed to reinstate the contract and stop the cancellation.

In addition, contract for deed buyers are not covered by certain statutory protections provided to mortgage purchasers, such as a right of redemption. Under Minnesota law, a farmer would generally have either 6 or 12 months after a mortgage foreclosure sale to “redeem”—repurchase—the property by paying the foreclosure sale price, plus interest, and certain expenses. During this redemption period the farmer can continue to use the land. This right of redemption is not available to farmers whose contracts for deed are canceled. Additionally, the right of first refusal—which gives some farmers another chance to buy or rent their farm after it has been lost to a creditor—does not apply when a contract for deed is canceled by a private individual.

From a seller’s perspective, contracts for deed can be risky because they require ongoing responsibilities. In contrast, mortgage-financed sales give sellers finality; the seller is usually completely finished with the sale transaction when the mortgage loan is made. If a mortgage buyer eventually has problems making payments, it is the lender—not the seller—who must take action. With a contract for deed, however, the seller is responsible for taking action if the buyer cannot pay or in some other way defaults on the contract. This could place a transitioning farmer in the difficult position of kicking a beginning farmer off the farm property, and could also result in lawsuits or other types of extended negotiations. Additionally, if a buyer defaults on a contract for deed, the seller would have to sell the property all over again.

**Q: Should farmers buy or sell farmland using contracts for deed?**

A: The answer is different for every farmer, depending on each farmer’s ability to tolerate risk, obtain loans, and manage private agreements over time.

In all cases, though, it is smart for both transitioning and beginning farmers to obtain legal counsel prior to entering into a contract for deed arrangement. At the very least, an attorney can review a contract for deed and identify potential risks and opportunities. This information can allow farmers to make informed decisions about whether a contract for deed is the right vehicle for buying or selling farmland.

**Q: How can the USDA FSA's Land Contract Guarantee Program protect sellers from default?**

A: For sellers entering into land contracts with beginning or socially disadvantaged farmers, the Land Contract Guarantee Program offers certain guarantees designed to provide an incentive to sell to these classes of farmers by reducing the seller's financial risk from buyer default on the contract payments. There are two types of guarantees that are available at the sellers' request. The first guarantee offered is a "prompt payment guarantee," which provides that FSA will guarantee up to the amount of three amortized annual installments plus an amount equal to the cost of any related real estate taxes and insurance incurred during the period covered by the annual installment. The second is a "standard guarantee plan," which provides that FSA will guarantee an amount equal to 90 percent of the outstanding principal under the land contract. Under either plan, the guarantee period is ten years regardless of the term of the land contract.

To obtain the guarantee, the land contract must include certain terms. New land contracts for farms with a purchase price of up to \$500,000 can be guaranteed under the program. The buyer must make a down payment of at least 5 percent of the purchase price, and contract payments must be of equal amounts during the term of the guarantee and amortized for a minimum of 20 years. The interest rate must also be fixed at a rate that does not exceed 3 percentage points above the interest rate of FSA's direct ownership loans at the time the guarantee is issued.

To qualify for assistance, both the buyer and the seller must meet certain eligibility requirements. The buyer's eligibility requirements are similar to those of FSA's Guaranteed and Direct Farm Ownership Programs. The buyer must also operate the farm during the term of the land contract, be the owner and operator of the farm subject to the land contract at the time the contract is completed, and must have a feasible business plan of operation that includes projecting the ability to make the land contract payments. The seller must have the capacity to enter into a legally binding contract, not have provided false or misleading statements or documents to USDA, not be disqualified due to a Federal Crop Insurance violation, and not be suspended or debarred from dealings with USDA.

It is important to note that the Land Contract Guarantee Program only provides protections for sellers through guaranteed payment in case of a buyer's default. It does not offer buyers any protection from forfeiture.