
REAL ESTATE CONTRACT vs. DEED OF TRUST

When a real estate transaction involves seller-financing, the unpaid balance of the purchase price (after the down payment) is generally secured by a real estate contract or deed of trust. Under a real estate contract, the seller retains legal title to the property until the contract is paid in full, at which time the purchaser is entitled to a deed. Under a deed of trust, the seller delivers a deed to the purchaser at closing, and the purchaser simultaneously executes a note and deed of trust in favor of the seller, conveying the property to a third-party trustee (usually a title insurance company). When the note is paid off, the trustee reconveys the property to the purchaser. Mortgages are now obsolete in Washington.

Functionally, either a real estate contract or deed of trust can be used in most seller-financed transactions. The primary differences lie in the remedies available to the seller in the event of default by the purchaser. Upon default by the purchaser under a real estate contract, the seller may elect to: (a) sue for delinquent payments; (b) enforce the contract; (c) forfeit the contract; (d) sue for the contract balance; or (e) foreclose the contract as a mortgage. The most commonly elected remedy is forfeiture. Under a deed of trust, the seller may elect to: (a) sue for delinquent payments; (b) enforce the deed of trust; (c) foreclose nonjudicially; (d) sue for the note balance; or (e) foreclose the deed of trust as a mortgage. Sellers most often elect nonjudicial foreclosure. Thus, the most important differences between real estate contracts and deeds of trust are the differences between forfeitures and nonjudicial foreclosures.

From the seller's perspective, the primary advantages of the real estate contract are that a real estate contract forfeiture is more than twice as fast as a deed of trust foreclosure (90 days compared to 190 days), and a forfeiture is much less expensive than a foreclosure (due to the prerogative to forfeit a contract without using an attorney; fewer required notices; no publication of notices; and no public auction). In addition, the readily available printed real estate contract forms are better than the deed of trust forms.

From the purchaser's perspective, the primary disadvantages of the real estate contract are that obtaining a "second mortgage" from a lender is more difficult when the purchaser is buying under a real estate contract, and that death or incapacity of the seller may cause problems with the transfer of title upon fulfillment of the contract by the purchaser. The latter disadvantage can be avoided by using a true escrow, into which the seller deposits an executed fulfillment deed at closing with irrevocable instructions to deliver the deed to the purchaser when the contract is paid off. An advantage of the real estate contract from the purchaser's perspective is the avoidance of reconveyance fees charged by the trustee when a deed of trust is paid off.

This article contains general information only, and should not be used or relied upon as a substitute for competent legal advice in specific situations.