



Investor Lease with Option to Purchase Explanation

A lease-option is a combination real estate rental, sales and finance technique. It is a property lease for a fixed time period, typically 24 months, with an option for the tenant to buy the property at an agreed option price during the lease term. Someone with poor credit and not a lot of liquid assets at the time, who can't afford a large down payment, are perfect candidates for this type of program. Buyers like lease-options because little up-front cash is required compared to a typical down payment. Investors also like lease-options because they provide necessary cash flow to pay the mortgage and property taxes from a tenant who has a vested interest in treating the property well, and who is likely to buy it.

Here is an example of how a typical lease with option to purchase may work:

Buyer/tenant is looking to buy a home, they have bad to decent credit, and at the time can't afford to put down 10 to 20% down towards the purchase of a home. They have spoken to their real estate agent and have decided they would be interested in a lease with the option to purchase. The buyer/tenant sits down with a real estate agent and possibly a mortgage consultant and figures out exactly how much they can afford per month. They may get pre-qualified for a loan amount based on their current situation to figure out exactly how much house they can afford at the time. Based on that information, the buyer/tenant will work with their real estate agent on finding them their home within that price range.

Depending on the type of home the buyer/tenant wants, you can go in a couple of different directions. First, if the home is a pre-existing home they may set up the lease with option to purchase with the current seller of the home. Although this is uncommon, it could possibly happen. Typically, a third party investor comes in and buys the property for the buyer/tenant (usually a new built home) and they establish the lease with the option to purchase before the sale of the target property. The investor becomes the landlord for the set term of the lease with the option to purchase and then sells the property to the buyer at anytime during the lease option period at a set price established at the time of contract. (typically 2 years).

Upon execution of the purchase option, the buyer/tenants real estate agent will draw up the documents to execute the transfer of ownership of the home from the seller to the buyer. The buyer/tenants lease option money and possibly any rent credit will be refunded to them to be used towards any possible down payment and/or closing costs to facilitate the execution of the transfer of ownership. Upon closing, the investor/landlord will receive their money from the investment, and the buyer will obtain ownership of the home.

Should the buyer/tenant decide to not go through with the purchase of the home after the set option period expires, should they default on the lease, or should they be unable to acquire financing, they may lose their option money deposit and any rent credits that may have accumulated during the period of the lease. This is for protection of the investor's investment. The investor/landlord is then free to do whatever he wants with the property at the time of default of the contract. The typical lease deposits (i.e. security deposit, pet deposit etc.) will be treated per the terms of the lease agreement.

There are two parts to a lease with the option to purchase transaction: the lease, and the purchase contract. The first part is the residential lease. Here in the state of Texas we have a lease contract that is used and has been provided to real estate professionals to use for any property in the state of Texas. This is the



most common contract that is used for lease properties within the state of Texas. Rent price will be established on this contract as well as how the lease deposits are handled.

The second part to a lease with the option to purchase is the option to purchase contract. This contract is drawn up by an attorney at the expense of the investor. This contract establishes the guidelines and responsibilities of both sides of the transaction to facilitate the transfer of property from the investor/landlord to the buyer/tenant. Some typical and important guidelines that this contract will layout are the following:

- The named parties of the transaction, property address.
- The term of the option period typically 1 to 2 years.
- Amount of option money. Usually 2-5 thousand dollars.
- The purchase price, or whether it will be sold at market value at the time of sale usually completed by a licensed appraiser
- Whether or not the contract is contingent on loan qualification at time of sale.
- Contract may be contingent on the buyer/tenant being enrolled in some kind of credit repair program, if needed.
- Amount of commissions paid at the time of ownership transfer.

Advantages for buyers

Lease-option benefits are not one-sided. Advantages for buyers include:

- **Small amount of up-front cash required**
The amount of up-front cash required to acquire a home or other property on a lease-option is usually small, often just a few thousand dollars for the first month's rent plus a refundable option consideration. This option money could possibly be used in lieu of a security deposit, but it is rare.
- **Monthly rent credit builds a down payment**
The unique characteristic of a lease-option is the rent credit toward the buyer's down payment. Typically, the rent credit is 5 to 10 percent of the monthly rent, depending on how motivated the seller is to sell.
- **Try out the property before buying**
Another special lease-option benefit for the tenant is the ability to try out the property before buying. If it is undesirable, the tenant hasn't tied up a large amount of cash in the home, and can leave easily.
- **Control property with very little cash**
The ability to control a property and profit from its market value appreciation with very little cash is called leverage. Lease-option buyers have this unique advantage.
- **Repair credit issues to increase purchasing power**
You will be working with a mortgage broker and a credit repair agency to help repair your credit to where it needs to be, to purchase the home back from the sponsoring investor.

Advantages for investors

Unless your property is located where there is very strong demand from buyers, lease-options can be especially advantageous for home sellers. Primary property seller advantages are:

- **Strong demand from prospective buyers**
No matter how slow the local real estate market might be, there is almost always a strong demand from lease-option buyers. Many prospective home buyers can usually afford the monthly payments



but often have insufficient cash for a down payment or an unqualified credit score. The lease-option solves this problem by giving the tenant-buyer a rent credit toward the down payment. It's like a "forced savings account." In addition, the tenant-buyer usually pays up-front nonrefundable consideration for the option, typically several thousand dollars.

- **Top dollar option price**

Because of strong buyer demand for lease-options, when done correctly, home sellers can demand and get top dollar for their properties. There are a couple of ways of setting the sales price of the home. First, the seller/investor can decide to sell the property at market value at the time of sale meaning if the home's market value goes up during the lease-option term, the buyer benefits. Should the property drop in value, then the tenant may lose the value in the home, and possibly back out of the contract, losing their option money. Second, and probably most common, is to establish the sales price up front (typically 10-12% above current market value), and after the end of option period, the tenant/buyer must pay the established price or lose the option deposit established at the time of contract.

- **Top quality tenants**

During the lease-option, the tenant-buyer usually takes good care of the property as if they own it.

- **Above-market rent**

Another seller advantage is earning above-market rent. Landlords can charge tenants 10 to 20 percent above market rent.

- **Seller keeps the tax deductions**

During the lease-option period, the seller retains all the property income tax deductions. If a tenant complains about not receiving any tax benefits, a reminder about the rent credit toward the down payment usually ends the discussion.

- **No lapse in tenants**

Since the tenant will be in the home for 1 to 2 years guaranteed there will be no lapse of tenancy upon purchase of the property. Your mortgage payments will be paid by the buyer/tenant's right away.

- **Longer terms mean greater profitability**

Although most residence lease-options are for short terms, such as one or two years, smart investors seek lease-options with the longest possible term. They reason the property is likely to appreciate in market value over the long term.

This is strictly an informational product to help you understand how a lease with the option to purchase works. Not all transactions are typical, and the terms and conditions can vary per transaction. I would be glad to walk you through this process. Please call me anytime to further explain how this program works.

I'm looking forward to making your estate experience memorable.

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