

## **The Lease Option**

A Strategic Tool for BOTH Buyers and Sellers

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Are you thinking about buying or selling a home? Is today's economy causing uncertainty about what to do? Are you confused about constant changes in policy by the banks and Federal government? To be sure, these are not comfortable times for a first time home buyer --- or a seller who knows their home is now worth less than it was a few years ago.

Buying and selling procedures common only a couple of years ago are no longer the case. Buyers face tough requirements from lenders – with demands for a high credit score, a large down payment, and a stable employment record being the norm. Sellers now discover their home is worth less than just a few years ago --- and possibly worth less than what they owe (underwater). It's common to see Foreclosure signs everywhere – and homes for sale sitting on the market for many months.

So where do the buyers and sellers look for help – to try and get the best advantage for their important real estate decisions?

Fortunately, a not often used tool, the **Lease Option**, can make a strategic difference for BOTH buyers and sellers. This tool is growing in popularity --- because it has distinct benefits for both parties in the transaction.

### **\*\* WHAT IS A LEASE OPTION?**

A Lease Option is a process where a buyer agrees to rent (**lease**) a property and then have the **option** to purchase the property at the end of the lease. In return for the seller (landlord) agreeing to delay the sale of the property for a period of time (? 1 to 5 years) at an agreed upon price, the buyer (tenant) pays an upfront, non-refundable fee. Often, the rent payment will include a portion of money that will be used later for all or part of the down payment.

### **\*\* ADVANTAGES FOR THE BUYER**

Buyers with credit scores in the low 600 range face increased costs by lenders for the 'risk' of lending money to them. Often, someone with a credit score of less than 620 will not be considered for a loan. By leasing for a year or two (or more), buyers can repair their credit to where lenders now consider them favorably.

In addition, buyers can better evaluate their choice of a 'future' home --- and decide as to whether their choice was the right one. Are they really cut out for home ownership? Does the responsibility and costs of maintaining/repairing/upgrading fit their lifestyle? Is the area they selected now the correct one? Are the schools suitable for the children?  
Doing a 'dry run' on their potential home can be a big advantage.

## **\*\* ADVANTAGES FOR THE SELLER**

The pool of potential buyers is significantly expanded. Not only will traditional buyers still be interested in the property, but a **huge market of renters** and investors now become available. And tenants who commit (option fee) to a future purchase will take better care of the property (this means seller peace of mind).

Financially, the seller now has rental income, and the home is no longer sitting vacant. In addition, the seller retains all the tax benefits. At the end of the lease or option period, if the tenant decides not to purchase, the seller keeps the rent plus the upfront option money. In total, these monetary benefits can be significant.

In the late 1970's and early 1980's lease options were quite popular as tools for financing properties for buyers with less than 'perfect' credit.

Today, many buyers are recent homeowners who lost their properties because of the collapse in home prices --- and made strategic decisions to walk away from what was a financially bad situation. These are intelligent, reputable homeowners who got caught when the bubble burst. Going through a foreclosure or bankruptcy damages a credit score – and these folk need some time to repair the damage. This is a big reason why a seller should seriously consider a lease option.

## **\*\* INITIAL BUYER PLANNING FOR A LEASE OPTION IS CRITICAL**

There are three important areas that must be addressed before a buyer undertakes a lease option. Keep in mind that the amount of rent and option money are always negotiable with the seller.

- 1) The monthly rent will usually be higher than 'fair market value' for the property. This difference in monthly rent is usually kept in a separate account and applied towards the purchase at the end of the option period. Is this increased rent within the budget for the buyer?
- 2) A key component of the lease option is the upfront option money. This is the money that the buyer will not get back if they decide not to purchase the property. The amount of the option fee is negotiable – and can be a small percentage of the purchase price agreed to in the contract (? 2 to 6%). Is this upfront option money available to the buyer?
- 3) Obtaining a mortgage at the end of the option period is essential. The buyer should consult with a **reputable** mortgage broker before doing a lease option – to best evaluate whether the buyer can get the mortgage money when it becomes necessary. If credit repair is needed, then a timeframe for the repair should be estimated, and this should drive the lease option period to be negotiated.

## **\*\* BUYERS --- HOW TO START THE LEASE OPTION PROCESS**

The first and most important step in moving ahead with a lease option is to enlist the help of a **qualified agent** with experience in the process. This involves in-depth familiarity with Lease/Rental Contracts, Residential Purchase Agreements, and Lease Option Agreements. **Coordination of all the terms contained in these three contracts is like walking through a minefield.** Insure you have an experienced Realtor who can advise both the buyer and the seller. A Realtor cannot advise you on legal matters. It is important to have a Real Estate attorney review all documents to best inform you as to the risks and best approach suited for your needs.

This Realtor can help find the property right for you. You are no longer limited to only looking for a rental. Consider this process as a normal house-hunting adventure! Describe a desirable area and type of property, your financial limits – and your Realtor can do a search for you. Once you find something of interest, your Realtor can make the appropriate contacts. Often times a seller is not considering a lease option, and can sometimes be persuaded to do so if shown all the benefits.

Your experienced agent plays a key role in the negotiations for buyers and sellers. You will need to be advised on today's purchase prices, and projected prices at the expiration of the option period. This will help determine the option period, monthly rent required, and the amount of upfront option money.

**There are many areas of caution that need detailed attention by both buyers and sellers.**

As always, safety comes from being informed, so you should plan on spending a lot of time with your agent to discuss many of the issues involved. After the agreements have been drafted, they should be reviewed by a real estate attorney.

Locating a reputable Mortgage Broker can also be facilitated by your Realtor. You must realistically understand your personal finances when viewed from a lenders perspective. This will then increase dramatically the chances of closing on the property at the end of the Purchase Agreement escrow --- and will lead to you being a happy homeowner in the house you've come to enjoy.

