What is a Rent to Own Contract?

-This is an agreement where a tenant, can rent a home from a landlord, with an option of purchasing the home at a later date, while allowing part of the rent to be accumulated and used at closing as down payment.

A landlord rents the home or condominium under a normal lease agreement. For an extra payment (fee), the tenant receives an option to buy the home at a later date, for a set price. Let's say the home is worth $280,000. The parties agree the tenant will have the right, but not the obligation, to buy the house in three years for $300,000.

What is an Option Payment / Fee?

-The fee for this right, or option, is normally 2 (two) per cent of the final price. In this example, 2 percent of $300,000 would be $6,000. This option payment is applied as down payment should the tenant exercise their right to purchase the property, but if the tenant does not exercise the option to purchase, this payment/fee is often kept by the landlord.

-if there is an option payment made at the start…………you should keep copies of the financial transaction, and proof of source of initial deposit
-where did money come from?
    -if from purchaser's account………obtain 90 day history of deposit
    -if from other source, make sure it qualifies for down payment. (i.e. borrowed from credit card may not apply)

What is a payment in excess of Fair Market Rent?

-Each month during the option period, the tenant pays has the option to pay more than the agreed upon rent, (say $200). That amount is accumulated and can also be applied as down payment should they exercise the option to purchase. At the end of the three-year lease term, the tenant has put up close to 4 per cent towards the purchase price option. In this example, it would be close to $13,200 ($6000 initial deposit, and $7200 in monthly payments)7,200.

How do we determine and document Fair Market Rent?

-when applying part of the rent to the purchase price………you must determine what is " current fair market rent " at the time of agreement by:
-having a Realtor provide a letter of opinion of market rent
-having an appraiser provide a letter of opinion of market rent
-document this further by keeping current Rental Advertisements from papers showing rental offers in the same neighborhood.

-remember…..it is only the amount that the client pays in excess of market rent that can be applied as down payment

-The Seller must hold these funds in a trust account

-The seller must keep track of all payments and dates (providing copies of monthly bank statements for this account is the best way to ensure that the bank will accept these monies when they consider financing the future purchase.)

-The bank may wish to see monthly audited proof of the rental payment going to the seller (to ensure timely payment).

This is where you must pay extra attention to ensure the contract is correct.

How should the contract be drawn up?

-It is always advisable to have a lawyer prepare the rent to own contract

-It is always advisable to register the rent to own contract on the property title. (note that many landlords prohibit registering a lien, however we suggest that it is in the tenants best interest to do so in order to protect their interest (and their down payment)

-ensure that the terms are clear and concise

-make sure that dates are set for start and expiry of contract

If the tenant exercises their right to buy, they can use the $12,000 as the down payment and apply for a mortgage to finance the rest of the purchase.

What are some of the advantages for the tenant?

-You may not have the down payment now, but you will have it at the end of your lease, as a result of the additional payments;

-If your credit is not good, you can improve it by making timely payments of rent;

-You can try out the neighborhood and if you change your mind later, you can just cancel the option (dependent on contract…..again we advise that a lawyer prepare the contract)

-If the market price of this home is more than $300,000 at the end of your lease, you still get to buy it for the same $300,000.

-If the market collapses and the home is worth less than $300,000, you do not have to go through with your purchase. (again dependent on contract)

<u>What are some of the disadvantages for the tenant?</u>

-There is no guarantee that a bank will give you your financing when you exercise your option. You still have to improve your credit score or find someone to co-sign your application;

-If you don't go ahead with your purchase, you usually have to forfeit the option payment. (again dependent on contract)

<u>What are some advantages for the landlord:</u>

-Tenants on rent-to-own typically take better care of the property, thinking that they may own it one day;

-Your profit is fixed at the time of the option.

RECAP:

-In all cases, it is important that the parties have legal advice. Some agreements state that if your rent is late once, the tenant forfeits the right to buy the home. This needs to be changed so that as long as the tenant cures any default in a timely manner, they do not lose the right to buy. The tenant should also have the title checked to make sure that the correct owner of the home is giving the option.

-Landlords need to make sure that the option payment is covered in a separate agreement, and is not included in the lease. If it is included in the lease and then the tenant defaults, if can be harder to evict the tenant from the property. Landlords also need to conduct a thorough credit and background check, to make sure that the tenant looks like they will have the means to make all of the required payments.

-Rent to own can work for landlords and tenants if you are properly prepared in advance.

Disclaimer…………..the guidelines above are meant as information only, and in no way guarantee that a bank will finance the property in the end. We recommend that the contract be prepared by a lawyer, and that the purchaser, and seller, always seek legal counsel prior to entering a "Rent to own" agreement.