

Investing in rent-to-own property



Rent-to-own companies say there is an untapped market of potential buyers and renters for your investment property who have been shut out of the traditional housing market. But is the risk worth the reward? We've gathered the facts so you can decide for yourself

The rent-to-own strategy is best known for how it can help tenants buy a home before they're financially approved by traditional lenders. However, rent-to-own is a strategy that doesn't operate without private investors who are in a position to secure financing and partner with a tenant who has a higher-than-average risk profile.

While home ownership is a universal desire, tight lending rules send more people to alternative lenders, and open up opportunities for investors who are interested in high cash flow for the short term.

Rent-to-own basics

When you invest in a rent-to-own property, you're purchasing a property

with a tenant in tow who, in the majority of cases, has helped select the property that they intend to buy at the end of a specified term.

In essence, you're helping to finance the property for a tenant who cannot receive traditional financing because of a few hiccups on their credit report.

Over the course of the lease, the tenant pays above market rent to live in the home, while a portion of the rent goes in an "option fund" toward their down payment.

At the end of the agreed upon term, the tenant has the right to use the "option" to purchase if their credit has been repaired, and they can buy the home with the down payment saved in their "option fund."

Tenant profile

Essentially, the rent-to-own tenant is someone who has bruised credit. (ie. not terrible, but that prevents them from qualifying.) These are the people who used to have good credit, until a divorce, illness or death in the family has caused them to default. They can be those who are self-employed and don't have the two-year work history, or simply those who don't have a large enough down payment.

"With the government and CMHC tightening up on their rules, we're getting better qualified clients all the time," says Mark Loeffler, investor and author of *Investing in Rent-to-Own Property*. "A few years ago, we were getting people in the mid 500s and now we're seeing people with 600, 620, 630 credit scores who can't get financing."

Owen Shaw of Integrity Wealth agrees. "There are fewer opportunities available, particularly for the self-employed. Over the last few years, banks have taken a lot of products off the market that allowed self-employed individuals to qualify."

Loeffler says most rent-to-own tenants have good income, bad credit, or good income, OK credit and not enough down payment.

Short-term benefits

So why would an investor go this route?

For one, you're collecting above

market cash flow on a monthly basis. Loeffler says tenants generally pay 20 per cent above market rents.

Secondly, it's a low-maintenance rental property because it does not require general maintenance, repairs or upgrades.

"We call it the hassle-free tenant strategy," says Owen Shaw, owner of Integrity Wealth Group, who has used this strategy often in his investment history.

In that way, you're ridding yourself of any property management fees and nixing the traditional landlord-tenant relationship. "In many cases, the investor is like an alternate lending solution," says Alex Kluge, President of Home Owner Soon Inc. "So tenants make their monthly payments and care for their home like it's their own, because they have every intention of purchasing it."

The flexibility of the contract is also

And that event happens about 50 per cent of the time, in Shaw's experience.

"For some people life changes and they recognize they're not in a position to follow through," he says.

Risks involved

"One drawback for the investor is that you're dealing with a higher risk profile from a tenant standpoint," says Kluge. "How you compensate for that risk is – depending on their credit situation – you get a higher down payment from them upfront. We typically ask for five to 10 per cent but sometimes as much as 15."

When dealing with tenants who cannot get traditional financing, there's always a risk that they will default on their payments or choose not to exercise their option to purchase. In either case, it's best to

» "In many cases, the investor is like an alternate lending solution. So tenants make their monthly payments and care for their home like it's their own, because they have every intention of purchasing it"

a benefit. "In most cases, you can write lease-to-own contracts any way you want," says Shaw. In some cases, the investor will lock in a certain value for the home based on where the market is currently, plus an annual appreciation rate (anywhere from four to eight per cent). In other cases, the investor doesn't lock in any price and it floats with the marketplace.

But in all cases, the contract will list a set time period for the term, at which point the tenant may purchase the home. If they're not quite there in terms of credit, the investor may choose to allow the tenant to continue to pay "rent" until they get there, or part ways – however, it should be predetermined in the contract what will happen in that event.

have a reserve fund. The tenant's option fund for their down payment will help in this regard. Loeffler says it typically takes two to three months to find an appropriate tenant if the investor chooses to re-rent-to-own the property.

However, in the event the tenant doesn't choose to purchase the property, the investor may choose to rent it out traditionally or sell the property.

Another risk is if the home appreciates at a higher rate than that set out in your contract. For example, if you set the appreciation rate at four per cent per annum in their lease-to-own contracts, and the price appreciates at six per cent per year, you've lost out on that

"A brilliant new book"
 Now available at better book stores



"Mark Weisleder has done an excellent job of taking apart real estate transactions and giving key details that only professionals know. His book can save you from expensive mistakes."

Ellen Roseman, Toronto Star

"A great resource for anyone considering buying or selling a home."

Pat Foran, CTV Consumer Reporter

MARK WEISLEDER
 Author • Speaker • Lawyer

www.PutThePenDown.com

Example:

OPTION TO PURCHASE AGREEMENT

Initial _____ Monthly Option Payment Credit (Non-refundable)
\$ _____ (The amount of the monthly option credit)

Estimated Total Monthly Credit at expiration of Option (____ months)
\$ _____ (the amount of the monthly option credit, unless that amount will change, this will most likely be the same number as above.)

Initial _____ (Initial Option Payment Credit (Non-refundable))
\$ _____ (the tenant's initial deposit)

TOTAL Estimated Option Payment Credit at time of purchase
\$ _____ (the total option credit amount at the end of the rental term plus the tenants' initial deposit)

In consideration of \$1 (ONE DOLLAR) and so long as the Occupant is not in default hereunder, Occupant shall have the option to purchase the real property described herein for a PURCHASE PRICE OF \$ _____ (CDN). (The final purchase price as determined by the appreciation rate per annum.)

EXERCISE OF OPTION: The option shall be exercised by mailing or personally delivering written notice to the Owner/Approved Agent, 60 days prior to the Expiration of Option and by additional deposit in the amount \$ _____ (CDN) (the exercise of option amount, usually the same as the initial deposit amount) payable In Trust to your Solicitor.

Notice, if mailed shall be registered mail, to the Owner at the address set forth below and shall be deemed to have been given upon the day following day shown on the post office receipt.

In the event the option is exercised, the "Original Option Money" and accumulated "Monthly Credits," if any shall be credited toward the purchase price for each month full occupancy fee has been paid when due. If the occupancy fee was late for any month, even for a period of one business day, credit will not be given for that month. These funds will only be credited if the option is exercised and the sale of the property closes. In particular, if the option is not exercised, the Occupant forfeits and the Owner retains all Options and Credits. If the Option is exercised, the Security Deposit, if any, and all interest will also be credited toward the purchase price.

By exercising the option, the Occupant states that their obligation to purchase is unconditional. In particular, Occupant states that required financing (if any) is in place.

EXPIRATION OF OPTION: This option may be exercised at any time, and shall expire 45 days before the last day of the Occupancy Agreement, unless exercised prior thereto. Upon Expiration, Owner shall be released from all obligations hereunder and all Occupant's rights hereunder, legal or equitable shall cease.

THE PURCHASE

COMPLETION DATE OF PURCHASE: This date shall be 60 days from the date of exercise of the option or such other date as the parties may agree upon.

Both parties recognize that this agreement is first and foremost a residential occupancy agreement, and the Occupant must not be in default under his/her Occupant obligations in order to exercise the option.

While you'll want to include other terms in relation to: Waiver of contractual right, applicable law, notices, heirs, assigns and successors, time, severability, gender, and entire agreement, here are a few terms in detail that you'll want to include.

EXTENSION OF AGREEMENT: If financing cannot be obtained due to no fault of the Occupant/Buyers, and provided this Agreement is in good standing and not in default, then this Agreement shall continue on a Month-to-Month basis for an additional six (6) months with no increase in the Monthly Fee or change in the Monthly Credits. The Purchase Price shall however increase at the rate of .5% per month. If after these additional (6) six months, the property still has not closed, then the Monthly Fee and Credits can, at the option and absolute full discretion of the Owner, be increased. The Purchase Price shall continue to increase at the rate of .5% per month.

LEGAL AGREEMENT: Owner hereby advises occupant that by signing this residential occupancy agreement with option to purchase, you will be entering into a legally binding agreement with owner. Owner recommends and advises the occupant to obtain independent legal advice regarding the terms of this agreement prior to signing this agreement. You acknowledge and agree that you have been given sufficient opportunity to obtain independent legal advice. You further acknowledge and agree that you have obtained such independent legal advice as you consider necessary and advisable;

ACCEPTANCE: The undersigned Owner accepts the foregoing and acknowledges receipt of a copy hereof. The undersigned Occupant hereby acknowledges receipt of a copy hereof.

In witness whereof, the Parties have executed this Agreement as of:

OWNER
Signature: _____

Printed Name:

OWNER
Signature: _____

Printed Name:

Address for service:

_____ (address of the property)

OCCUPANT
Signature: _____

Printed Name:

OCCUPANT
Signature: _____

Printed Name:

potential appreciation because you've agreed to sell to that tenant at the predetermined price.

"The house could be worth more than you agreed to sell it for," says Kluge. "I actually think that's a good thing because you're making a lower return but you've got a tenant who's motivated to buy the property, even more so now because the house is worth more."

Finally, investors must be prepared to deal with active investments, as they'll be turning over properties every three years, as opposed to 15 or 20, says Loeffler.

Is this for you?

Investors who are looking for high short-term cash flow may want to consider this option. In addition, those looking for low-maintenance properties in terms of repairs and property management are well-suited for this type of investment.

"If their personal strategy is to hold

In most cases, you can write lease-to-own contracts any way you want

the property long term and then live off the cash flow or the ability to refinance without paying taxes, then this wouldn't work," says Shaw. "But if the person's personal strategy is to buy a property inexpensively and then dispose of the asset at the highest possible market value with as few intermediary expenses such as real estate agents then the lease-to-own strategy is fantastic."

However, people skills are a must as you're effectively entering into a partnership with the tenant, says Kluge.

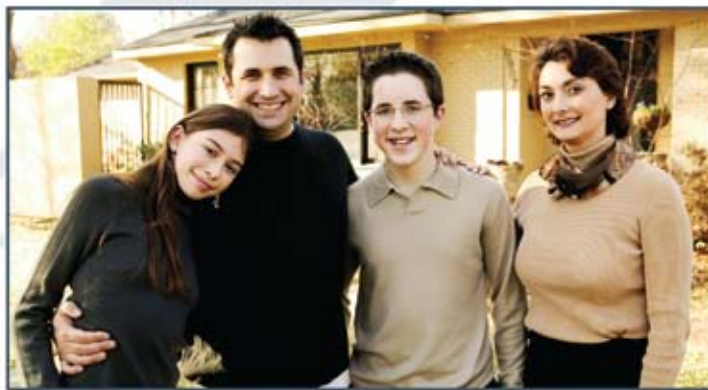
"This is a people-based business," says Loeffler. "We're managing tenants and their credit reports. I see people who were doing this by themselves a couple of years ago and they're coming to term, but their tenants still have credit problems and won't be able to buy at the end of the term because they haven't coached them at the end of the day. You have to get into this business to help people. You have to refer them to a credit specialist, a mortgage broker or something to ensure that you're doing your part to help them purchase the home."

DIY and rent-to-own companies

Doing it yourself, can be a time-consuming process, mainly because it takes time to properly market your opportunity, screen and qualify a tenant/buyer.

But if you choose this route, it is important to advertise the opportunity online and respond to those looking for

Having a Challenge Finding Great Investment Properties? Having a Challenge Finding Great Tenants? We Have the Solution!



www.renttoowninvestor.com
www.homeownersoon.com
1-866-702-4334
info@homeownersoon.com

Building wealth with a social conscience one family at a time.

housing. “The key to being successful is to explain and advertise this process to the prospective purchasers in the simplest of terms,” says Shaw.

Afterwards, you must choose a tenant and qualify them in much the same way a traditional lender would.

It is the investors’ responsibility to do their due diligence in the same way a traditional lender would by asking for verification for all information and checking their credit score. Credit scores will help determine the length of the term needed.

For example, Loeffler follows this rule:

- 560 or less: three-year term
- 560 to 620: two-year term
- 620 and up: one-year term

“The biggest mistake rookie investors make when doing rent-to-own is they choose the wrong tenant,” says Kluge. “You need one that is qualified, has a substantial security deposit and will be in a position to purchase at the end of the term.”

But it doesn’t stop there. Once you have a tenant, you must have a system in place to ensure their credit is repaired by the end of the term.

There are a handful of companies across the country who will help facilitate the rent-to-own process.

While each company operates slightly different, most charge a fee based on the purchase price of the home (usually two to four per cent).

These companies screen tenants and match the tenant profile you’re looking for with you as an investor. The tenant-first approach is the most popular and the most successful, because the tenant shops for the house they want, rather than trying to fit a tenant into a previously purchased property.

In addition, Kluge says companies such as Home Owner Soon, not only secures the tenant, but obtains the down payment on their behalf, collects post-dated cheques, creates and facilitates the signing of the offer to purchase, facilitates the home inspection, puts the lease agreement together and ensures it is signed, sends all documents to a lawyer, facilitates



» “When the market is not favourable to selling, when it’s very competitive and there are a lot of products on the market, use lease-to-own to differentiate yours from other inventory and to give your property a competitive edge in the marketplace”

the mortgage through a broker, obtains insurance for them and arranges for keys to be supplied to the tenant.

When choosing a company, look at its track record and get referrals from existing clients and investors. See how the company’s transactions work, interview the head executives and determine how comfortable you are working with them, says Kluge.

Ensure they have a background in real estate contracts and experience underwriting.

When to use this strategy

While the majority of lease-to-own transactions use the tenant-first

strategy (ie. the tenant selects the property) as opposed to the property-first strategy (whereby the investor has a property he or she is looking to find a renter/buyer for), if the latter option is your preference, timing is key.

Shaw says rent-to-own is best used as a disposition strategy in weak markets. “When the market is not favourable to selling, when it’s very competitive and there are a lot of products on the market, use lease-to-own to differentiate yours from other inventory and to give your property a competitive edge in the marketplace.” ■