

# HOW RENT TO OWN WORKS

A Guide To Rent To Own Homes



# INTRODUCTION

Are you on the path to homeownership but find the initial expenses daunting? Perhaps you're navigating the real estate market but facing challenges with loan qualification due to a less-than-ideal credit score. Or, you might be a forward-thinking student eager to dive into homeownership right after graduation.

Rent-to-own could present an appealing option for you. This guide aims to demystify the rent-to-own process, a pathway that, while not uncommon, often leaves many puzzled. By the end of this guide, you'll gain a comprehensive understanding of rent-to-own, discern whether it aligns with your goals, and learn the steps to embark on this journey.

Adding to this, it's worth noting that rent-to-own agreements offer a blend of renting flexibility with the future promise of ownership, making it a strategic choice for those building their credit or saving for a down payment. This guide will also touch on key considerations to ensure this arrangement works to your advantage, helping you make an informed decision towards achieving homeownership.



# How Rent To Own Works



Rent-to-own, also known as lease-option, blends renting and buying into a single process. It allows you to lease a home with the option to purchase it later.

## HOW RENT-TO-OWN WORKS

In this arrangement, a tenant agrees to rent a property with the option to buy it at a predetermined price before the lease expires. The process starts with an initial, small option fee. Throughout the lease, the tenant may receive rent credits, which can be used towards the purchase price or other housing costs. This approach is particularly appealing for those not ready for a traditional home purchase, providing a way to move into a home immediately without a large down payment or mortgage qualification.

The rent-to-own model benefits both buyer and seller. Buyers are motivated to purchase the property to recoup their initial investment, including the option fee and any premium payments. This setup creates an incentive for buyers to ultimately buy the property, aligning interests and fostering a win-win situation.

When a seller agrees to a rent-to-own contract, they commit to selling the home to the tenant-buyer if the latter decides to purchase during the lease term. This arrangement restricts the seller from offering the property to other potential buyers until the lease ends. However, the sale is not guaranteed within the lease period since the tenant has the option, but not the obligation, to buy. The seller relies on the likelihood that the tenant aims to reclaim their invested funds through purchase.

Should the tenant opt not to buy, the seller still benefits from the rental income during the lease term. Although the primary aim was to sell, not merely to rent, the seller gains additional compensation if the tenant walks away, through the forfeiture of the option fee and any rent credits.

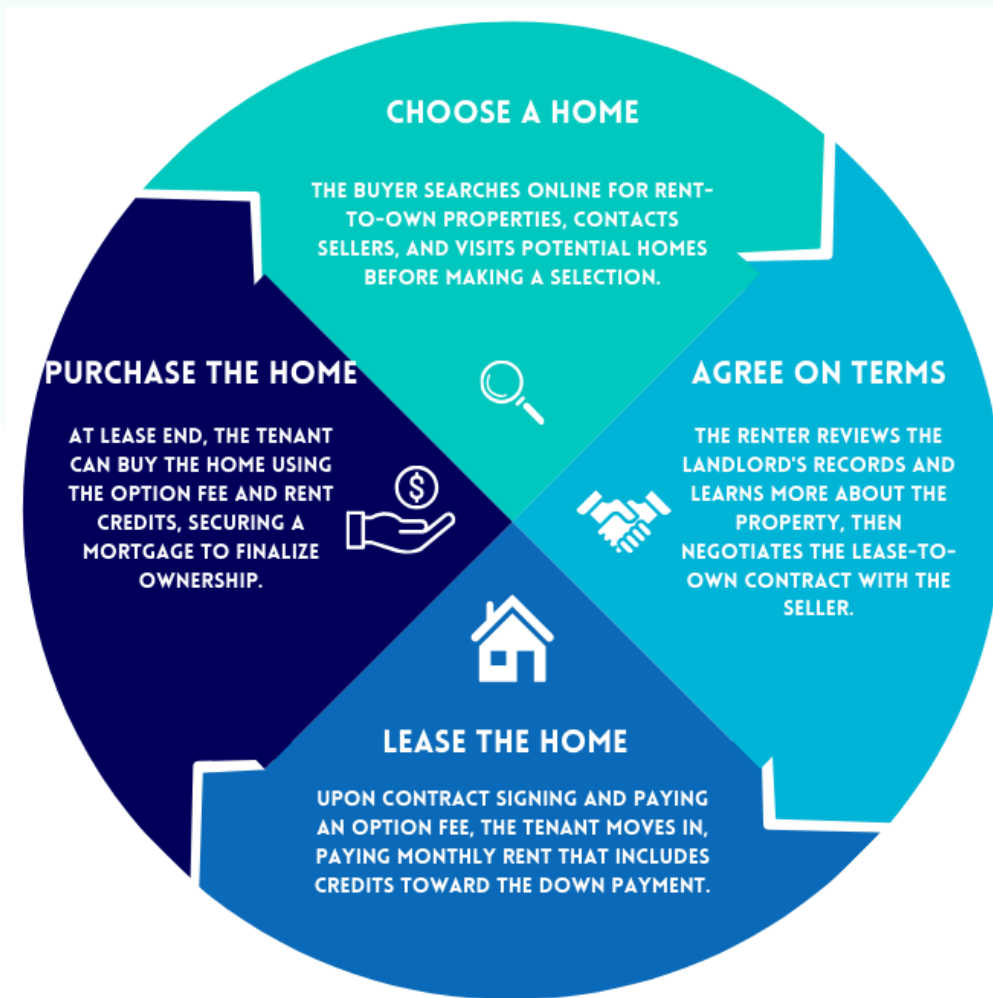
Renting to own a home bears similarities to lease-purchase agreements for furniture or electronics, where the item is essentially on loan until the buyer can pay in full.

### **WHAT IS A RENT-TO-OWN HOME?**

A rent-to-own home is one that an owner intends to sell but may face obstacles, such as legal or market conditions, delaying an immediate sale. For instance, pending probate or a sluggish market could make a conventional sale challenging. To avoid the property sitting vacant and potentially attracting unwelcome attention, the owner might choose a rent-to-own agreement. This way, they can generate income through renting while waiting for a more favorable selling environment or for legal issues to resolve.

### **RENTING TO OWN A HOME: A SIMPLE GUIDE**

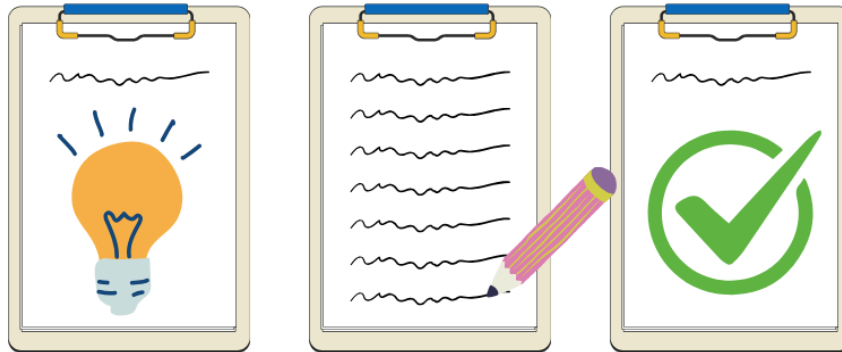
Embarking on a rent-to-own agreement involves a few straightforward steps, setting the foundation for a more in-depth exploration of potential complexities in later sections of this guide.



Renting to own a home involves locating a property available for this arrangement, making a one-time option fee payment, leasing the home as usual, and then proceeding to purchase when you're prepared. Upon deciding to buy, the seller applies the option fee towards the purchase. If you opt out of buying, the seller retains the option fee.

Naturally, the process includes finer details, which vary according to the terms of your specific agreement.

# The Contract Basics



Every lease agreement comes with its set of obligatory terms, and rent-to-own agreements are no exception. In this portion of our rent-to-own manual, we'll delve into the essentials of the option-to-purchase contract, highlighting important aspects to consider in your rent-to-own journey.

While every contract is unique, commonalities exist in their core components. Essential elements that should be part of any option-to-purchase contract include:

- **Purchase Price**
- **Standard Rent**
- **Closing Timeframe**
- **Maintenance and Other Fees**
- **Option Fee**
- **Rent Premium**
- **Buying the Home**

To assist you further, we've compiled a Rent to Own Contract Checklist along with a sample Rent to Own Contract, ensuring you're well-equipped with all necessary resources.

## Rent to Own Contract Checklist

### PRIMARY THINGS TO INCLUDE

- ☒ Option deposit \_\_\_\_\_
- ☒ Duration of the leasing period \_\_\_\_\_
- ☒ Purchase price of the house \_\_\_\_\_

### SECONDARY THINGS TO INCLUDE

- |   |   |
|---|---|
| <input type="checkbox"/> Homeowner's name _____               | <input type="checkbox"/> Amount of monthly rent premium _____               |
| <input type="checkbox"/> Tenant's name _____                  | <input type="checkbox"/> Rent credit going towards downpayment _____        |
| <input type="checkbox"/> Address of property _____            | <input type="checkbox"/> Who pays for utilities and property charges _____  |
| <input type="checkbox"/> Date the agreement is created _____  | <input type="checkbox"/> Who pays for maintenance on the home _____         |
| <input type="checkbox"/> Costs of monthly standard rent _____ | <input type="checkbox"/> Contract adheres to local and state laws _____     |
| <input type="checkbox"/> Date monthly rent is due _____       | <input type="checkbox"/> Contract has clear terms and conditions _____      |
| <input type="checkbox"/> Grace periods on monthly rent _____  | <input type="checkbox"/> Is reviewed by real estate lawyer (optional) _____ |

### NOTES

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## OPTION TO PURCHASE REAL ESTATE

THIS AGREEMENT is made and entered into this \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, by and between \_\_\_\_\_, (hereinafter referred to as "Optionor/Seller"), and \_\_\_\_\_, (hereinafter referred to as "Optionee/Purchaser").

WITNESSETH, that for and in consideration of the non-refundable payment of \$\_\_\_\_\_ to Optionor/Seller by Optionee/Purchaser and the mutual promises and covenants hereinafter set forth, the parties hereto agree as follows:

1. **Form of Contract of Sale.** Seller binds himself to enter into a contract with Purchaser, a copy of which is annexed hereto and made a part hereof as Exhibit "A", upon the exercise by Purchaser of this option.
2. **Expiration of Option.** This option shall expire on the \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_.
3. **Extension of Option Period.** Purchaser shall have the further option, on or before the \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, to extend the option period for an additional period of \_\_\_\_\_ days, to the \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, upon giving notice of the extension of the option period to Seller prior to the \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, and tendering to Seller the amount of real estate taxes for the extended period payable upon the property covered by this option and additional consideration in the amount of \$\_\_\_\_\_. Only one such extension shall be granted under this option agreement.
4. **Method of Giving Notice.** This option is to be extended and exercised by Purchaser giving written notice, mailed by certified mail, return receipt requested, to Seller at \_\_\_\_\_.
5. **Agreement Binding.** This Agreement shall be binding upon the parties hereto and their respective heirs, administrators, successors, and assigns.
6. **Governing Law.** This agreement, and all transactions contemplated hereby, shall be governed by, construed and enforced in accordance with the laws of the State of \_\_\_\_\_. The parties herein waive trial by jury and agree to submit to the personal jurisdiction and venue of a court of subject matter jurisdiction located in \_\_\_\_\_ County, State of \_\_\_\_\_. In the event that litigation results from or arises out of this Agreement or the performance thereof, the parties agree to reimburse the prevailing party's reasonable attorney's fees, court costs, and all other expenses, whether or not taxable by the court as costs, in addition to any other relief to which the prevailing party may be entitled. In such event, no action

*\*Besides consulting this guide, consider engaging an attorney for contract review, as the terms may be complex. Legal advice can streamline your process, ensuring you fully grasp the rent-to-own conditions and reduce the risk of fraudulent agreements.*



### 1. PURCHASE PRICE

At the start of your lease-option agreement, a purchase price for the home is set, reflecting its anticipated fair market value at lease end. To gauge the current market value, use a home value estimator available on most major banking websites. For future value predictions, seek advice from a local mortgage banker for expert insights. This agreed-upon price is fixed throughout the lease period, unaffected by future market fluctuations.

### 2. STANDARD RENT

Your monthly rent amount is predetermined for the lease's duration, similar to any rental contract. It's wise to verify that this base rent is in line with the current market rates by consulting a local mortgage banker, ensuring you're not overpaying. Any excess payments should ideally contribute towards a rent credit. Additionally, ensure your payments cover the property's mortgage, taxes, and insurance to avoid foreclosure risks.

### 3. CLOSING TIMEFRAME

The lease term length is negotiable; it should mirror the time you estimate it will take to accumulate the down payment. Clarify with the seller the payment schedule for the lease, mortgage, and any incidental expenses to maintain timely payments and avoid future disputes.

### 4. MAINTENANCE AND OTHER FEES

Determine who is responsible for maintenance costs, utilities, and other property fees. Rent-to-own buyers often handle all maintenance, repair, and utility costs, a departure from traditional rental agreements.

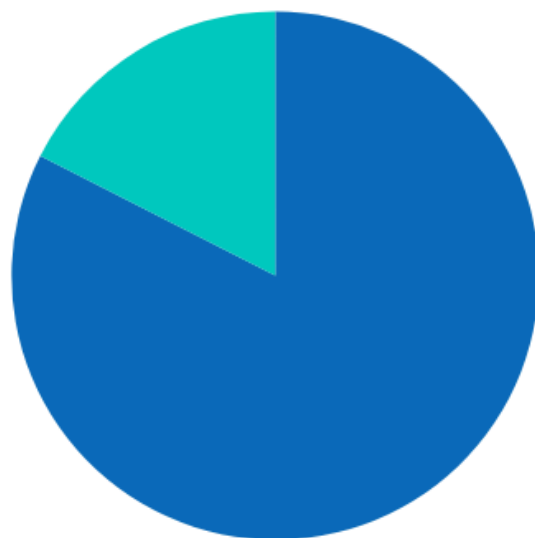
Landlords typically cover the property taxes and insurance since they retain ownership responsibilities. It's crucial to address issues like renter's insurance and property modifications while drafting the contract to avoid future misunderstandings.

### 5. OPTION FEE

The option fee secures your exclusive right to buy the home later. This fee is generally non-refundable and varies from 2% to 10% of the home's purchase price. Should you qualify for a mortgage during the lease, you can use the option fee and any rent credits toward the down payment. It's important to note that paying this fee is mandatory to maintain the purchase option.

For clarity, consider this scenario: Jamie is interested in a rent-to-own home priced at \$150,000. For a conventional mortgage, a 20% down payment, or \$30,000, is required. At her lease's start, Jamie pays an option fee of \$5,250 (3.5% of the home price). When she proceeds to buy, this \$5,250 is credited towards her down payment, effectively covering 17.5% of it.

**Covered by Option**  
**17.5%**



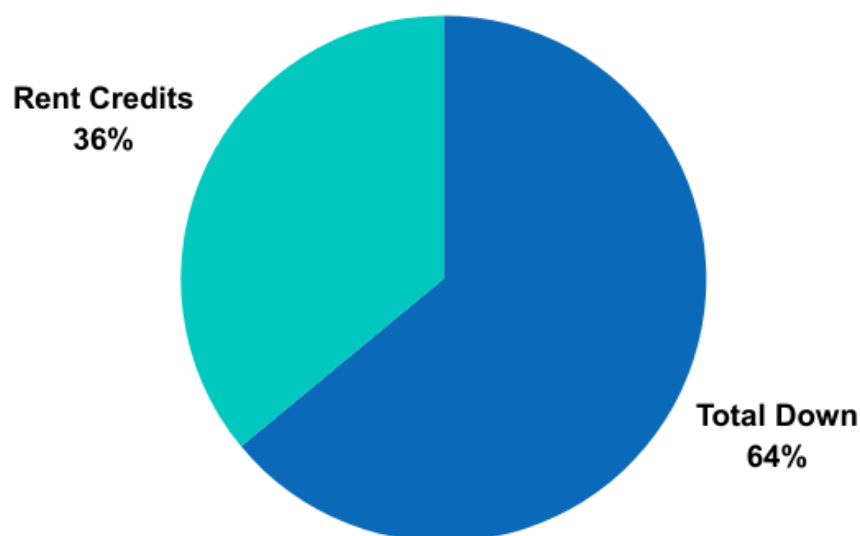
## 6. RENT PREMIUM

Beyond your monthly rent, you may pay a rent premium, which contributes toward the home's future purchase, serving as a rent credit. This method helps build equity before you buy. Rent premiums, which can range from 15% to 25% of your rent, mean a higher total monthly payment but with a portion going towards home ownership.

Upon deciding to purchase, the rent premiums paid are deducted from your down payment. Note, only this premium part of your rent aids in building equity, not the total rent.

These premiums are stored in an escrow account by the seller, separate from their personal finances, and are applied to your down payment along with the option fee if you buy the home.

If you don't buy, the seller keeps all the rent premiums. Continuing the previous example, if Jamie agreed to a standard rent of \$1,500 and an additional \$300 monthly as a rent premium, her total rent would be \$1,800. Over three years, this accumulates to \$10,800 in rent credits, or 36% of the down payment.



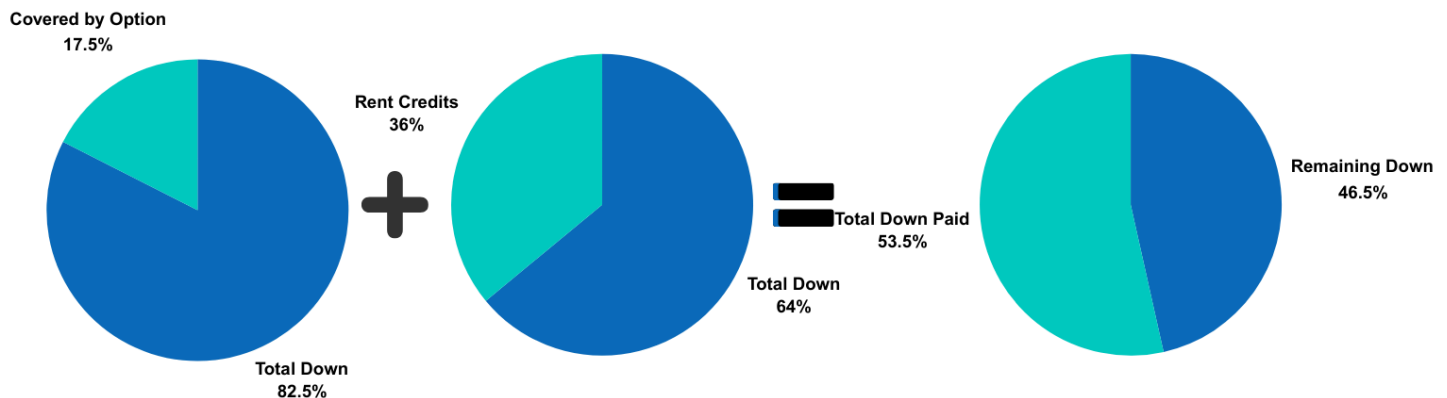
## RENT CREDIT VARIATIONS

Some sellers offer to charge fair market value for rent and then credit a portion of that back if you decide to purchase the home. This arrangement can be particularly beneficial for the buyer, though it's not very common. In such a scenario, Jamie would save the same amount of money as previously mentioned, but instead of paying \$1,800 per month, she would only pay \$1,500 per month. Another frequent approach is for the seller to match the buyer's premium payments.

Continuing from the earlier example, let's see how rent credit matching works: The seller of the home Jamie is renting-to-own agrees to match Jamie's \$300 premium payment. Therefore, instead of saving \$300 per month, Jamie is saving \$600 per month. Over three years, Jamie saved \$21,600, or 72 percent of the down payment cost.

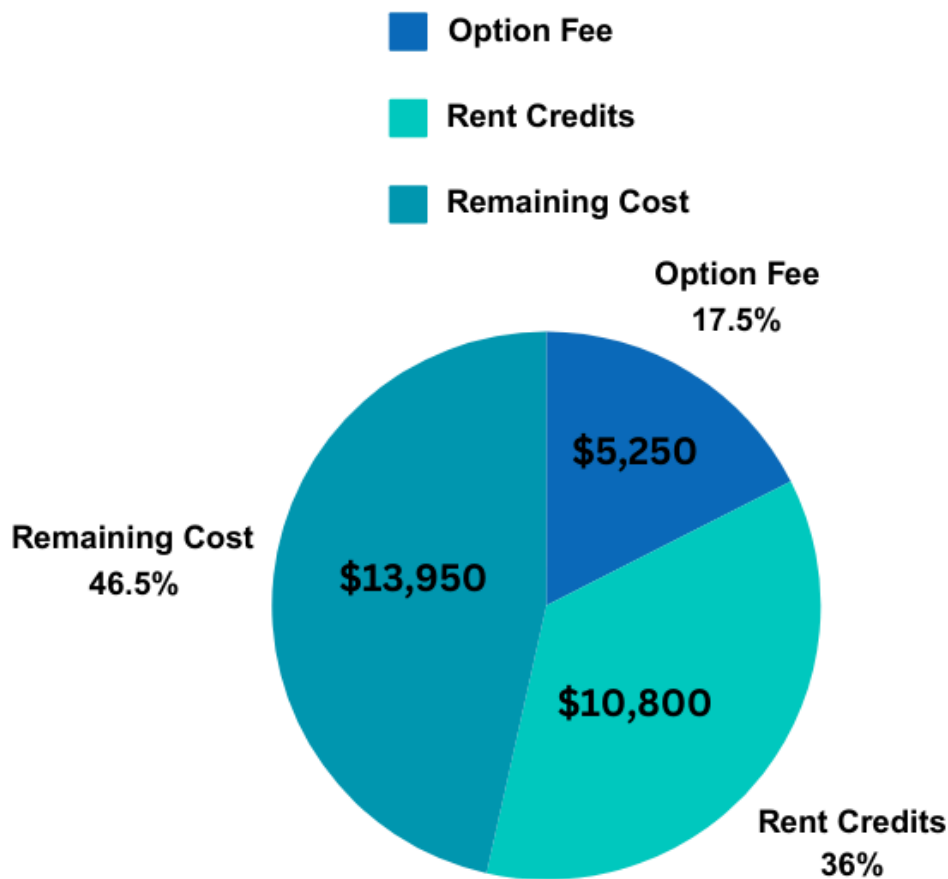
## 7. BUYING THE HOME

Now that we've covered how standard rent, rent credits, and option fees function, what happens when the lease concludes? Let's calculate our total savings at the end of the lease term: Since Jamie's option fee was \$5,250 and her accumulated rent credit amounted to \$10,800, by the end of her lease she has saved \$16,050, which is about 53.5 percent of the down payment.





Should you find yourself unable to afford the home or choose not to proceed with the purchase at the lease's end, the non-refundable option fee and any accumulated rent credits will be forfeited. This means you'll lose any equity you've built up in the home, with the seller retaining both the option fee and the rent credits.



Viewing a lease-option agreement as a commitment to purchase is crucial. Weighing the advantages and disadvantages thoroughly is essential to safeguard against potential losses. The following section will delve into some of these critical considerations.

# How Rent To Own Works

Rent-to-own agreements come with several advantages that could significantly benefit your financial future. However, without careful consideration, a lease option might adversely affect your finances for years to come. Understanding the pros and cons of rent-to-own is essential for making an informed real estate choice.

### **Pro #1: Accumulate Equity and Boost Credit Score**

Rent premiums contribute directly to your down payment, typically representing 15-25% of your standard rent. Over time, this can add up to a considerable sum, unlike traditional renting where monthly payments don't build equity.

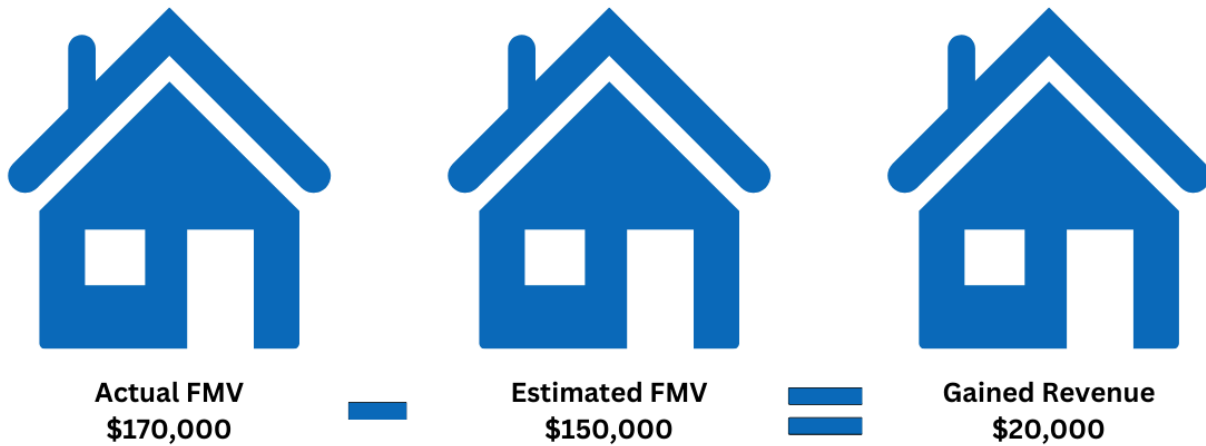
Rent-to-own is particularly beneficial for individuals looking to improve their credit score. It provides an opportunity to rebuild credit without the immediate need for a strong credit history, as rent-to-own contracts are more accessible. By maintaining lower balances, paying bills on time, and reducing debt, you can enhance your creditworthiness.

### **Pro #2: Lock in a Purchase Price**

One major advantage of rent-to-own is securing the home at a fixed purchase price, shielding you from future market fluctuations. This certainty allows for better financial planning and might encourage more disciplined personal spending, possibly enabling you to buy the home sooner than expected. Additionally, if the market value of the home increases above the agreed price by the lease's end, you stand to benefit financially. For instance:

For example, imagine Jamie and the seller estimate the home's future fair market value (FMV) at \$150,000 three years down the line. If the actual FMV at that time rises to \$170,000, Jamie realizes a gain of \$20,000. This scenario underscores the

potential financial advantage of locking in a purchase price early in a rent-to-own agreement, especially if the property's value increases over the lease term.



### Pro #3: Get to Know the Home and Area

A key benefit of a rent-to-own arrangement is the opportunity to thoroughly acquaint yourself with the property and its surroundings before committing to purchase. This period allows you to discover the home's advantages and areas for improvement, assess the neighborhood's fit for your lifestyle, and identify any necessary repairs or upgrades.

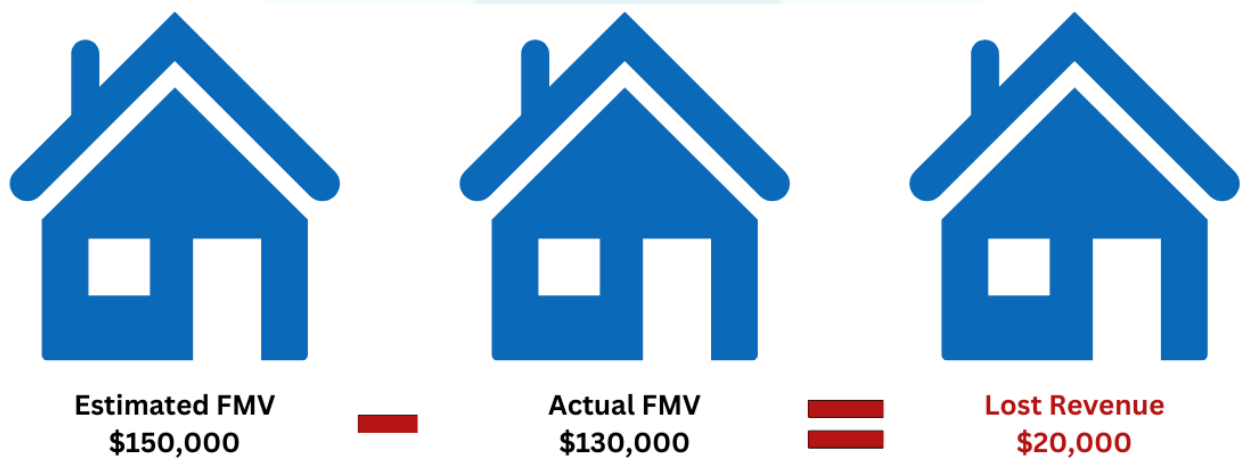
### Con #1: Adhere to Strict Guidelines

Rent-to-own agreements impose stringent rules, especially regarding payment deadlines. Timeliness is critical; failing to pay rent on time, even by a single day, can lead to significant repercussions. For example, a late payment might result in losing that month's rent credit towards the home purchase, effectively reducing the equity you've built. Let's explore how delayed payments can impact your equity in a rent-to-own scenario:

Jamie has a monthly rent credit of \$300. Over her 36-month rent period, she incurred nine late payments. Consequently, Jamie would forfeit a total of \$2,700 towards the home's purchase cost.

### Con #2: Potential for Unpredictable Risks

Engaging in a rent-to-own agreement brings inherent uncertainties and potential risks. One risk is the possibility of overestimating the home's future value, leading to a situation where you might pay more than its actual market worth. For instance, if Jamie and her seller predict the home's future fair market value (FMV) to be \$150,000, but it ends up being only \$130,000, Jamie faces a \$20,000 loss.

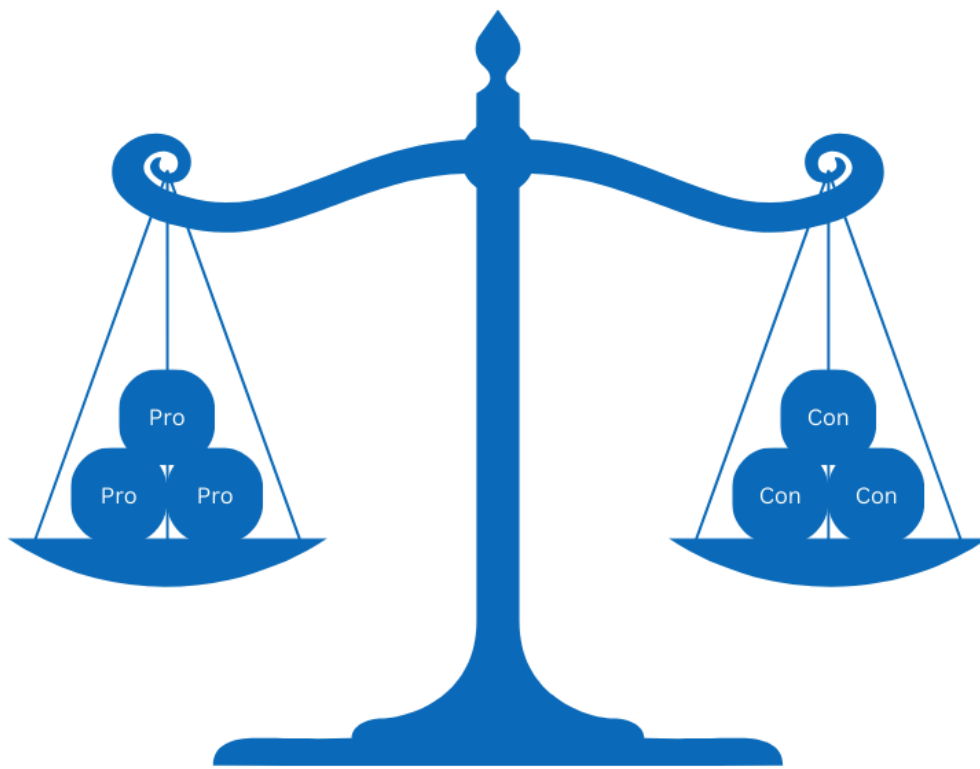


Furthermore, risks can also stem from the seller's financial situation. If the seller fails to manage mortgage, tax, or other financial obligations for the property, there's a risk of foreclosure, resulting in the potential loss of the home for you. Additionally, if you're unable to fulfill the purchase at the contract's end, this could lead to significant financial strain and debt accumulation on your part.



## Should You Rent-To-Own?

As highlighted in previous parts of this guide, rent-to-own agreements come with numerous advantages. Nonetheless, their value can vary significantly based on one's financial circumstances and may not always prove beneficial over the long term.



# Alternative Options

If, after delving into this guide, you find that rent-to-own isn't the right fit for you, don't worry. This could be due to various reasons, such as a low credit score, overwhelming debt, or maybe you have sufficient savings for a down payment or mortgage. Fortunately, there are alternative paths to homeownership, and we're about to explore some of the most common ones.

## 1. Traditional Home Purchase

If you're financially able to, purchasing a home with a conventional mortgage is often preferable to a rent-to-own situation. It's especially advantageous if you're ready to make a 20% down payment and meet the lender's criteria regarding credit scores and employment history. This option allows you to bypass rent payments and start building equity immediately.

## 2. FHA Loan

Initiated in the 1930s under Franklin D. Roosevelt, the FHA loan program remains a popular choice for homebuyers. With this program, you can buy a home with as little as a 3.5% down payment if you have a credit score of at least 580 and fulfill other financial requirements. An FHA loan is essentially an insurance scheme where you pay premiums to cover potential lender losses. Opt for this if you're prepared for homeownership but can only afford a minimal down payment.

## 3. Renting

For those who need time to improve their credit score or save for upfront costs, renting is a viable option. This approach gives you the flexibility to prepare financially until you're ready to embark on a rent-to-own agreement or pursue another path to homeownership.

# Deciding to Rent-To-Own?

After thoroughly reading our guide and considering your options, you've decided rent-to-own is the way to go. Initiating the rent-to-own process can appear challenging with its myriad responsibilities. Nevertheless, armed with proper guidance, navigating these waters can be made simpler. Here's a structured approach to embarking on your rent-to-own journey:

### Step #1: Select a Property

Begin your search online, exploring various homes. Narrow down your choices, then reach out to the sellers for a visit. Use these meetings to familiarize yourself with both the sellers and the properties. During your visits, scrutinize the homes for any signs of damage or disrepair. Don't forget to investigate the neighborhood at various times to gauge whether it suits your living preferences.

### Step #2: Consult With Professionals

Once you've chosen a property, delve deeper with comprehensive research. Seek advice from an experienced mortgage lender who can guide you on improving your credit score. A minimum score of 580 is often required for loan qualification, though some lenders might demand a score of 620 or higher. A better credit score significantly eases the financing process for the home. Also, it's crucial to learn about the property's history and verify the seller's reliability by examining their past dealings.

### Step #3: Finalize the Option to Purchase Contract

Having consulted with professionals, you should now have a clear grasp of your duties under an option to purchase contract. The critical move before transitioning into the home is to collaborate with the seller on formulating the lease-option agreement. During this contract creation phase, it might be wise to engage a real estate attorney frequently to ensure you fully comprehend the contract's various provisions. An attorney can also help evaluate the seller's terms and confirm their legitimacy, protecting you from potential legal pitfalls.

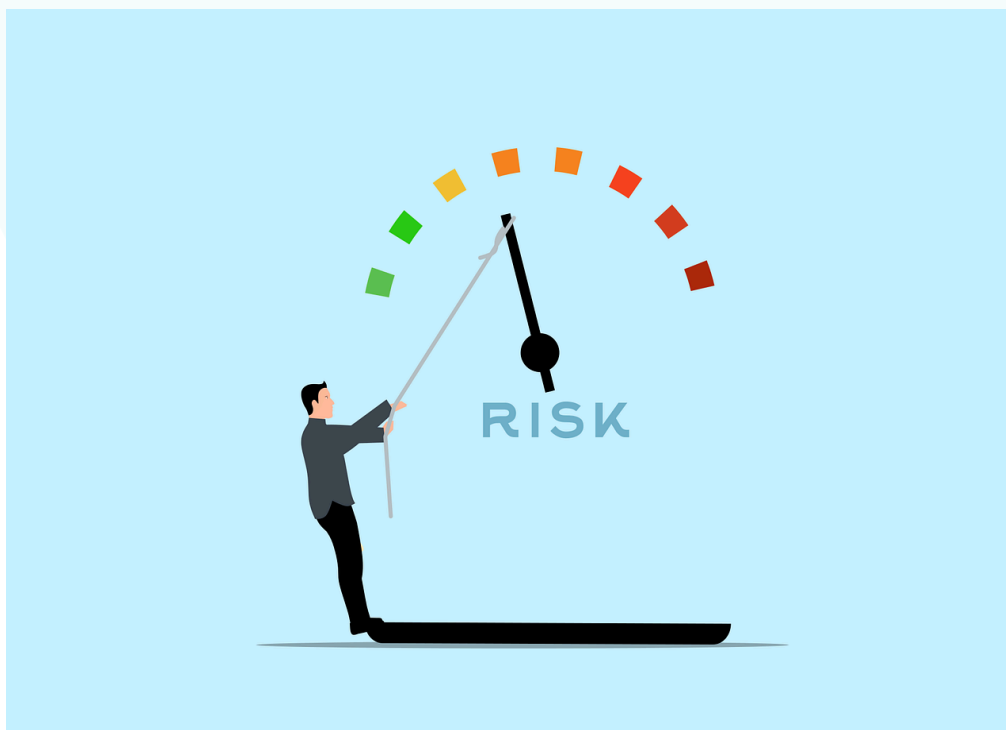
### Step #4: Transition into the Home

With the option to purchase contract signed, the next exciting phase is moving into your new home. Yet, the journey toward homeownership continues. Maximizing the rent-to-own benefits requires diligent effort to bolster your financial standing throughout the lease. This means elevating your credit score, maintaining steady income, and accumulating savings for the eventual down payment.





## How to Manage Risk



Navigating the complexities of legal agreements, such as rent-to-own contracts, demands a keen awareness of potential risks. A common pitfall for buyers is entering these agreements without adequate forethought, exposing themselves to unforeseen consequences. To help you navigate these waters more safely, here are strategies to lessen these risks:

### 1. Conduct Thorough Research

Gathering comprehensive information about the property is paramount. Lack of information is a significant misstep in any option to purchase contract. Start by examining the seller's public records to check for any past illegal activities. Next, seek out all accessible data regarding the property to ensure there are no hidden issues or anomalies. Finally, weigh the advantages and disadvantages carefully.

### 2. Improve Your Credit Score

Enhancing your credit is a key advantage of the rent-to-own path, as it sets a foundation for future financial stability, especially in preparation for buying a home. Being clear-eyed about your financial health is crucial; failing to secure a mortgage at the lease's end means losing your option fee and any equity you've accumulated. Consulting with financial advisors or credit repair professionals before embarking on a rent-to-own agreement is a wise move to ensure you're on the right track.

### 3. Fully Commit to the Property

Signing the option to purchase contract essentially indicates your intention to buy the property. Considering the initial option fee and rent premiums paid for the purchase right, backing out post-lease could mean significant financial loss. It's crucial to approach a rent-to-own agreement with a strong commitment to eventual homeownership, ensuring you're not ambivalent about the decision.

### 4. Have a Contingency Plan

Even with meticulous planning and risk mitigation, unforeseen issues can arise in a rent-to-own agreement. Life is unpredictable, but having a plan B can ease potential setbacks. For instance, to safeguard against mismanagement of your equity by the seller, consider arranging for your payments (rent credits and option fee) to be held in an escrow account. This third-party account ensures your funds are secure and only released under agreed conditions, providing an additional layer of financial safety until you're ready to buy or the lease concludes.

# What Now?

In conclusion, the rent-to-own route demands the same level of commitment and scrutiny as any other home buying method. If your ultimate aim is homeownership, such a significant choice should be approached with due diligence.

Prospective rent-to-own buyers face various risks, including potential scams. It's imperative to conduct thorough research and carefully assess the advantages and disadvantages before committing to an option to purchase contract. This careful approach can help ensure that your path to homeownership is both informed and secure.