

What are Lease Options?

By: Bill and Kim Cook

As I began learning about Lease Options, I grew more and more excited. One morning I told Kim that we needed to start using Lease Options to sell some of our investment properties. Not using Lease Options was costing us money – a lot of money.

What is a Lease Option? The complete phrase is “Lease with an Option to Purchase”. Thus it is called a “Lease Option”. It means that the person (tenant/buyer) is Leasing (renting) the owner’s (Landlord’s) property and has the right to buy the property within a pre-agreed-upon time and at a pre-agreed-upon price and terms.

Three main documents are used when doing a Lease Option. A Lease Agreement, an Option Agreement, and a Purchase and Sale Agreement.

The person who is giving the Lease Option (the property owner) is called the Optionor. The person who is getting the Lease Option (the tenant/buyer) is called the Optionee.

You will also see a Lease Option called a “Rent to Own” or a “Lease Purchase”. There is a slight difference between these three, but there isn’t room in today’s column to cover them.

How does a Lease Option work? If Charles wants to buy a property but can’t or doesn’t want to buy it immediately, and he is concerned that the owner will sell the property to someone else, Charles may want to do a Lease Option.

When doing a Lease Option, Charles will sign a Lease Agreement (rental contract), Option Agreement, and a Purchase and Sale Agreement. These documents give Charles the right to rent the property and then purchase the property by a pre-agreed-upon date, for a pre-agreed-upon price and terms. For this right, Charles pays the property owner a “Non-Refundable Option Fee”.

Why does Charles pay the owner a Non-Refundable Option Fee? When the property owner signs the Option Agreement, he is giving up his right to sell his property to anyone except Charles, and he must sell to Charles at the pre-agreed-upon price and terms. Charles is paying the owner to give up these rights.

Now the two big questions: How long does an Option Agreement last? And how much is paid as an Option Fee? It is whatever is agreed to between the Optionor and the Optionee. It can be for five minutes or a thousand years. The Option Fee can be one penny or twenty billion dollars. The terms are whatever is worked out between the two parties.

One thing you should know, we don’t recommend an Investor **buy** a property using a Lease Option. Why not? What if a property owner had a house that was in rough shape? After a major rehab it would be worth \$100,000, but currently, because of the rough shape, it can be bought for \$50,000.

An Investor Lease Options the property, pays the owner a \$5,000 Non-Refundable Option Fee, and the owner agrees the Investor has the right to buy his property anytime within the next year for \$50,000.

The Investor does a \$20,000 rehab to the property and it looks great. Next he finds a buyer who agrees to a purchase price of \$100,000. The Investor contacts the property owner to say he wants to exercise his Option to purchase the property.

This is where the wheels can – can, not will – fall off the cart. What if the property owner refuses to sell? “But he has to sell! We have a signed Option Agreement!” you say. True enough, but you can’t force the property owner to sit at the closing table and sell you his property.

“I’ll take the guy to court!” you say. Yep, and you’ll probably win. But how much time and money will that cost? Meanwhile, you have a lot of your money tied up in the deal and you still must make rental payments to the owner or you may be evicted.

That lump you feel in your throat right about now is your wallet!

Next week we’ll cover why we love using Lease Options to sell real estate.

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