Rent-to-Own Agreements

Rent-to-own agreements offer a unique path to homeownership for individuals facing hurdles such as credit challenges, new jobs or insufficient down payments.

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This alternative arrangement provides a middle ground for both buyers and sellers, allowing tenants to gradually transition from renting to owning a property.

A rent-to-own agreement is a contractual arrangement where a tenant agrees to rent a property for a specified period with the option to purchase it at the end of the lease term. This type of agreement typically involves two components: the lease agreement and the option-to-purchase agreement.

The lease agreement outlines the terms of the rental, including monthly payments and responsibilities, while the option to purchase agreement grants the tenant the right to buy the property when the lease expires. There are two types of rent-to-own contracts. Lease-option contracts do not require the buyer to purchase the property at the end of the lease term. Lease-purchase contracts make the purchase mandatory.

HOW RENT-TO-OWN WORKS

Rent-to-own agreements often span two to five years, allowing tenants ample time to improve their financial standing. During this period, tenants pay a monthly rent that includes an additional premium, known as the "rent credit," which contributes toward the future down payment to buy the property.

To secure the option to purchase, tenants typically pay an upfront fee, known as the option fee. This fee is negotiable and is not refundable, serving as a commitment from the buyer to consider purchasing the property at the end of the lease term. It is typically applied to the down payment.

The purchase price of the property is agreed upon at the beginning of the lease, shielding the tenant from market fluctuations. If the property appreciates during the lease term, the buyer may benefit from locking in a lower price. Typically the purchase price is set at a higher amount than the property's current value.

The contract will also spell out who is responsible for utilities, maintenance and taxes.

CONSIDERATIONS FOR BUYERS

Prospective buyers must assess their financial situation and ensure they will be in a position to secure a mortgage when the option to purchase becomes available. Improving credit scores and saving for a down payment are critical steps.

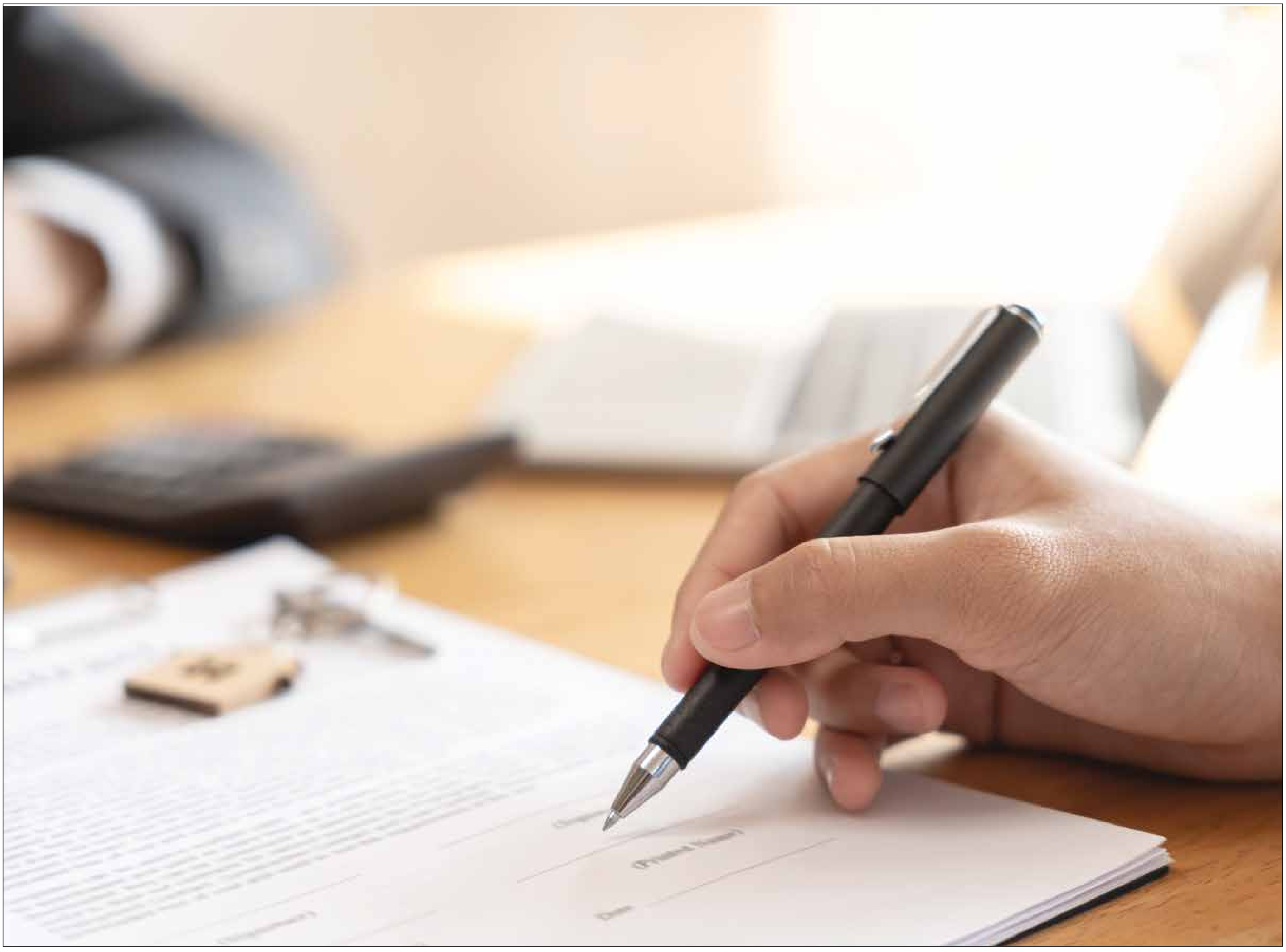
Conduct a thorough inspection of the property before entering into a rent-to-own agreement. Identifying potential issues early on can prevent complications during the purchasing phase.

HomeTrek emphasizes that being in a rent-to-own agreement does not make you more qualified for a mortgage at the end of the term. You still have to improve your credit and make sure the rent credit contributes what you need it to in order to have a sufficient down payment. You can ask your landlord to report your mortgage payments to the credit bureaus — just be sure that you pay your rent on time. They also warn that some people use rent-to-own agreements as scams, so it is important to research them well and make sure they are legitimate.

CONSIDERATIONS FOR SELLERS

Sellers should accurately assess the current market value of the property and set a fair purchase price in the agreement. This ensures a mutually beneficial arrangement and avoids potential disputes.

Seeking legal advice is crucial when drafting a rent-to-own agreement. An attorney can help ensure the contract complies with local regulations and safeguards the interests of both parties.



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REAL ESTATE 101

Fair Housing Milestone

In 2021, on the 100th anniversary of the Tulsa Race Massacre, President Biden launched an interagency initiative called Task Force on Property Appraisal and Valuation Equity (PAVE) to fight bias in home appraisals during home buying or refinancing.

HOMEWISE GLOSSARY

Equity: the value of a homeowner's unencumbered interest in real estate. Equity is computed by subtracting from the property's fair market value the total of the unpaid mortgage balance and any outstanding liens or other debts against the property. A homeowner's equity increases as he pays off his mortgage or as the property appreciates in value. When the mortgage and all other debts against the property are paid in full the homeowner has 100% equity in his property. **SOURCE:** Illinois Real Estate Lawyers Association