

How to Sell Your House Using a Lease Option

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Are you trying to sell your house in a buyer's market? A lease option may be the perfect solution to ensure you get top dollar for your home and maybe even generate some extra income off the sale. Lease options, in which you lease (rent) your property to a potential buyer who has the option to buy the property at the end of the lease term, can allow you to tap into a huge pool of people who want to buy a home but who, for one reason or another, aren't quite ready to make the purchase yet.

If you, or a friend or family member, have been trying to sell your home, and it has been on the market for three months or more, find out how you can sell it in 21 days or less with [this free report](#).

STEPS:

- **Decide if a lease option is right for you.** A lease option isn't for everybody. If you need all the money from the sale of your home right away, you're better off with a straight sale. In addition, the majority of lease options aren't exercised, so you may have to begin the process of selling your home all over again after the lease term. You might also think twice about a lease option if you don't want to, or aren't able to, keep up with the responsibilities of continuing to own the home. In the lease option scenario, the owner must continue to pay property taxes and insurance and is generally still responsible for major repairs during the lease term.
- **Place an ad.** Many sellers are simply approached by buyers who want to do a lease option, but if you're sure you want to go this route, you can place an ad in the paper or online. Ads for lease options typically receive a tremendous response, so you'll likely have plenty of potential buyers to choose from.
- **Do a background check on applicants.** At this point, you have to look at potential buyers as potential tenants, and you don't want to do a lease option with somebody who you wouldn't rent to. That means, not only do you have to do a credit check on them, you also need to do a criminal background check. That's the last thing you need is for the authorities to come haul away your

tenant.

- **If you run ads on free Internet sites like Craigslist**, or anything similar, make sure you meet with that prospect “face to face” in a public place and ask for credentials. You never know who you're dealing with nowadays, and you sure don't want to become the next victim of a scam.
- **Look for someone with good references**, a steady source of income, and the ability to pay the rent plus, if applicable, the additional monthly option money. As far as the applicant's credit history, you probably don't want someone with serious credit trouble, but at the same time you may want to be somewhat lenient. Many buyers who choose lease options do so because they have some blemishes on their credit and want to improve their profile before applying for a loan.
- **Pre-qualify your lessee**. This step is often skipped, but it shouldn't be. It's a good idea to contact a loan officer or mortgage broker to at least discuss the potential buyer's prospects for obtaining a mortgage at the end of the lease term. There is more uncertainty (and, hopefully, more chance of improvement) the longer the lease term, but both you and the potential buyer can get a realistic idea of whether they'll be able to buy the house. This step is essential if it's important to you to sell the house at the end of the lease, but ethically, and perhaps legally, it's important regardless of your preference because if you take option money and above-market rent from a tenant who can't possibly buy the house at the end of the lease, you're just ripping the tenant off.
- **Provide the potential buyer with a seller's disclosure form**. The disclosure form lists any known problems with the house. You attest, to the best of your knowledge, to the condition of the house. This form is standard for other purchase transactions but is sometimes left out in a lease option. Make sure you give the buyer this form to help him or her make an informed decision and to protect the integrity of the contract and sale. The buyer should also have an independent home inspection done.
- **Negotiate a contract and collect option money**. You can get fill-in-the-blank lease option forms online, but you're better off getting them from a local real estate agent or attorney. The contract is sometimes added as an addendum to a standard sales contract. Unless you really know what you're doing, get help with the details of the contract from an attorney or a real estate agent. The most important thing to remember is that you've got to cover not just the money issues but also who is responsible for what types of repairs and other complications that are bound

to come up.

- **Agree on the purchase price of the home, which should be fixed on the lease contract.** You'll be obligated to sell at this price, so you want to make sure it's something you can live with. Ideally, the agreed-upon price should be based on a fair market value and maybe slightly more (especially for lease terms of 1 year or more) to compensate for the convenience to the buyer and for the likely appreciation of the property over the term. You and/or the buyer may want to pay for an appraisal to validate the price. Banks and other lenders will only loan against the appraised value, regardless of the price that you agreed on with the buyer.
- **Determine how much option money to collect.** Some states and municipalities have laws specifying a maximum amount of option money that can be taken, but in general the initial option money or option fee can be almost any amount. A typical figure is 2-4% of the purchase price. You will keep this money no matter what. If the lessee decides to buy, the money will be credited toward the down payment or the purchase price, and if the lessee doesn't buy, he or she forfeits the option money to you.
 - Keep in mind that many buyers choose lease options because they can't come up with a big down payment, so don't expect to be able to get a huge amount of initial option money.
- **Decide how much of the lessee's monthly payment will be credited toward the option.** Anywhere from 0-100% of the monthly payments can be credited toward the purchase price, although the amount is sometimes subject to state or local laws. In general, the monthly payment will be calculated at fair rental value plus a set amount that will go toward the purchase price. This, like the initial option money, will either be credited toward the down payment or the purchase price or, if the tenant doesn't buy, will be forfeited to you.
- **Decide on the term of the lease.** Lease options typically run anywhere from 6-24 months. Less than six months usually doesn't make sense for the buyer, and more than 2 years (sometimes more than 1 year) may cause tax or legal complications. Shorter lease terms generally result in sales more than longer terms, simply because there are so many variables over the long term, but the length of the lease should be adequate to ensure that the lessee has time to get his or her financial ducks in a row.
 - Keep in mind that if housing prices appreciate quickly, you may be getting a bad deal on a long lease, since you're obligated to sell at the agreed-upon price. If housing

prices decline, however, you may be getting a good deal, but if they've declined significantly, the lessee is unlikely to buy the house. You still get to keep the option money, however.

- **Get the proper insurance coverage.** Since you will no longer be the owner-occupant of the house, you may need to update your homeowners insurance policy to a dwelling policy. Check with your insurance agent to determine what policy is necessary and what coverage you need. Your tenant should also be insured to cover his or her liability and, depending on your state, any gaps in your coverage that may result from the lease option.
- **Collect monthly payments.** Now, all you need to do is collect the payments each month. Keep track of the payments received so you'll have a record when the time comes for the lessee to exercise the option (or, in the the worst-case scenario, when you have to go to court to settle a dispute).
- **Sell the house.** At the end of the term the lessee can exercise the option to buy the house for the price specified on or before the date specified. The total option money paid (including the initial option money plus any credit from the monthly payments) will go toward the down payment. Thus, the buyer already has equity in the home and should find it easier to get a loan.

TIPS:

- Charging higher-than-market rent on a lease option is a good business decision and is legally, ethically and morally justified—as long as you don't go overboard. Values in some municipalities are subject to some local variations if the excess money is credited as option money. Some sellers opt to charge just the fair rental value so that only the initial option money is credited toward the purchase. Still another variation is to charge fair rental value and credit a portion of this toward the option. This is a great deal for the buyer, but can lead to complications with financing later, so you should check with your real estate agent or loan officer for details.
- You can usually still deduct your mortgage interest payments from your income taxes during the term of the lease option. In general, you also do not need to pay any tax on the option money until the lease ends. At that point, you will need to include it in your capital gain from the sale of the house or, if the sale doesn't go through, report it as rental income.
- Consult a tax professional for more details. Many sellers opt to carry the loan on the house themselves. This should generally be

spelled out in the initial contract. In some states, if the total option money paid exceeds 5% of the agreed-upon purchase price, you may need to go through foreclosure proceedings to evict a tenant that isn't paying rent. With this in mind, sellers in these jurisdictions usually structure the contract so as to keep the option money below 5%.

- Who makes repairs? Generally, the owner is still responsible for major repairs, but the lease option contract can assign responsibilities for minor repairs to the tenant. If the house is a "fixer-upper," you may be able to rent it under a lease option even if you legally couldn't under a standard lease, though this is dependent on local laws. The tenant, by improving the home during the lease term, can increase its market value, thus building "sweat equity" in the house that will make it even easier for him or her to get a favorable loan. Whatever the situation you choose, make sure the division of responsibilities for repairs are clearly spelled out in the contract.
- Get two deposits. Make sure that if you will be requiring a Down payment from your "Buyer" that it is clearly marked as a non-refundable down payment. Make sure to have a completely separate cleaning deposit in case your buyer decides to just be a renter and backs out of the contract.

WARNING:

- Lease option lessees generally have more incentive to take care of the house than typical renters, but you can still run the risk that your tenants will tear the place up and default on the lease or decide not to buy. The laws and customs of your jurisdiction may vary, so consult a real estate agent or attorney before entering into a lease option.
- If the value of your property has increased substantially since you bought it then you may want to consider the tax implications of the capital gains on your property. You can deduct up to \$250k (\$500k if married and filing jointly) from your federal return if you have owned and lived in the property for at least 2 of the past 5 years. Put another way, if you lease the property for 4 years and then sell it, you can not take that deduction and will have to pay capital gains on the appreciation. In any case, check the laws with your local realtor or real estate attorney.
- Make ABSOLUTELY sure you know what it means to be a landlord and what the local laws and regulations are governing the Landlord-Tenant relationship. Make certain that you are willing to be a landlord.