Investing in Real Estate with Lease Options and “Subject-To” Deals

Powerful Strategies for Getting More When You Sell, and Paying Less When You Buy

WENDY PATTON

John Wiley & Sons, Inc.
Investing in Real Estate with Lease Options and "Subject-To" Deals

Powerful Strategies for Getting More When You Sell, and Paying Less When You Buy

WENDY PATTON

John Wiley & Sons, Inc.
This book is dedicated to my mother who, in 1985, got me started in real estate investing by giving me my first real estate course. It was her belief that real estate investing was the true way to financial freedom that led me to discover my future direction in life. She believed in me.

I want to thank my husband, Michael, and my children, Brooke, James, Jacob, Rachel, and Sarah, for sacrificing without me during the time I was writing this book and especially during the many times over the years that I was buying and selling real estate. Brooke and James, my twins, were with me through hundreds of homes, when I was a single mother. Their patience was worth its weight in gold!

I want to thank my sister, Jenny, who helped me with most of the editing of my book—for the many long hours she spent. Also, many thanks to Ron Cazier, Scott Teerink, John Hyre, Veronica Johnstone, Kris Mezsets, Amie Leszczynski, and Lyle Reichenbach, for your help in editing and offering your expertise in different sections. I could not have done it without you.
# CONTENTS

**INTRODUCTION**  
Lease Options—Anyone Can Do It!  

**PART 1**  
**AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS**  

<table>
<thead>
<tr>
<th>CHAPTER 1</th>
<th>How Lease Options and Subject-Tos Work and How They Can Set You Up for Future Financial Freedom (FX3)</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHAPTER 2</td>
<td>Success Stories of Buying on Subject-Tos and Lease Options</td>
<td>18</td>
</tr>
</tbody>
</table>

**PART 2**  
**STEPS TO BUYING PROPERTIES ON LEASE OPTIONS AND SUBJECT-TO DEALS**  

| CHAPTER 3 | Finding Motivated Sellers for Lease Options and Subject-Tos | 31 |
| CHAPTER 4 | Lease Options versus Subject-Tos: Choosing the Right Technique for the Right Situation | 44 |
| CHAPTER 5 | Evaluating the Profitability of the Deal | 61 |
| CHAPTER 6 | Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos | 76 |
| CHAPTER 7 | Getting the Paperwork Ready for a Lease Option Deal | 95 |
| CHAPTER 8 | Getting the Paperwork Ready for a Subject-To Deal | 110 |
| CHAPTER 9 | Advanced Concepts and Strategies for Buying on Lease Options and Subject-Tos | 120 |
CONTENTS

PART 3
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

CHAPTER 10  Building Rapport and Sharing Lease Options with Realtors 135
CHAPTER 11  Closing Deals with Realtors 150

PART 4
STEPS TO SELLING PROPERTIES ON LEASE OPTIONS

CHAPTER 12  Finding and Qualifying a Good Tenant-Buyer 161
CHAPTER 13  Getting the Paperwork Ready for the Tenant-Buyer 175
CHAPTER 14  Managing the Property and the Tenant-Buyer 195
CHAPTER 15  Closing: The Big Payday 207
CHAPTER 16  Advanced Concepts and Strategies for Selling on Lease Options 212

PART 5
CREATING FUTURE FINANCIAL FREEDOM—FX3

CHAPTER 17  Business Organization for Lease Option and Subject-To Investments 221
CHAPTER 18  Where to Go from Here: A Step-by-Step Action Plan 232

GLOSSARY 245
RESOURCES 251
INDEX 253
INTRODUCTION

Lease Options—
Anyone Can Do It!

Fourteen-year-old John, with his father, attended a seminar that I spoke at in Houston. During one segment of my presentation I usually teach the students how to call sellers directly out of the newspaper. When I teach this part of the class I often make live calls to sellers so that my students can hear how I speak with the seller and how I gather information to determine whether their home is a potential candidate for a lease option. On this day, however, I didn’t make any calls—we simply talked about the best techniques for calling leads.

The next day, while John was in school, he began circling the “For Rent” ads. After school he started making calls—with no caller training—and he got a seller lead for a lease option who said, “Yes, I’d like to consider it.” However, being only 14 and having no experience, he couldn’t and didn’t know how to enter into a legal contract. He asked his father, “What do I do?”

John ended up selling the deal to another investor in their local investment group for $500. He gave me a copy of his $500 check. Not bad for a 14-year-old kid and one to two hours of work. John immediately went on to develop a relationship with this local investor, and on his next deal (while still 14!) made 50 percent—$14,000—of profit for his assistance in the deal. He has since done additional deals for much higher profits.

How and why can a 14-year-old kid do this when most adults would not? Fear! I believe that we all have fear of failure and/or fear of success. At 14, he was not afraid of failure. He just applied what he learned and tried it.

You are never too old or too young to start investing. If you can
do the research and pick up the phone to make the calls, you are on your way. However, many of us stop before we even get started because of our fear. We might have excuses like, “I can’t possibly do that. It’s a young person’s game. It’s an older person’s game. No one will say ‘yes’ to me. I have no experience. I don’t have a good voice. I don’t have money. I don’t have good credit.” All are negative talk and incorrect statements.

What’s going to make you successful in lease optioning or subject-tos is just taking the plunge. You’ll make some mistakes along the way, but so what? What’s the worst thing that can happen?

John wasn’t hampered by fear and so was able to jump in, take the plunge, and make things happen—setting his financial future in motion. His example does not involve a huge amount of money, but it’s nothing to sneeze at—it is a fantastic amount for most people and extraordinary for a 14-year-old. The money is important not only because John now can pay for college, but now he also has choices. If he continues on his path in real estate investing, he will have the chance to be independent and work for his own interests, unlike most of his friends. Choices imply options, including personal and financial freedom!

For me, the most exciting facet of real estate investing is Future Financial Freedom—or, as I call it, FX3. Everyone has a different definition of freedom; for some it is financial, for others it means having more control over their time.

Let me have one of my boot camp students explain this in their own words to you:

Dear Wendy,

Our financial future has literally changed within the past couple of months by applying what my husband and I learned from your boot camp and, even more importantly, what we’ve learned from your ongoing, personalized support—you truly are the best! Keep in mind, my husband thought that I was crazy when I signed us up for your boot camp and flew up from Florida to Michigan to hear you speak. It truly was the best thing we have ever done. Please share my personal testimonial with your classes. I’m a believer, this does work!

First off, I have to mention that when we attended your seminar, we had just completed a 1031 exchange, which gave us the great opportunity to start our investing career by buying three houses. Yes, it was so great having three houses sit-
ting empty and one with a renter that lived off of us for free!
This renter was so nice she gave a whole room to her pet rab-
bits to roam freely in, after we had just rehabbed the house!

During your boot camp we had a wonderful gathering
at your house, in which my name was drawn to purchase a
house on a lease option. I jumped for joy like I had just won
a prize. The next day, after the [beer] wore off, I figured out
what I had just committed to—a house that is 1,000 miles
away, where it actually snows, the pipes freeze, and they have
things called basements! Yes, being from Florida, this is just
what I’ve always wanted—not!

We were up for the challenge, and you made it so easy
with your support, along with the great contacts and help
that we had from others who attended the boot camp. Not
only did we get a great purchase price and terms with the
owner, but today we have a pending contract for a lease op-
tion that will cash-flow us $600 a month, and at the end of
the 18- to 24-month term we will profit $107,400! Gosh, I
guess that will cover the cost of the class—truly amazing!

When we came home from your class we decided “no
more renters.” We booted the bad renter out (and no, we didn’t
keep the rabbits!) and sold all of our houses on lease options.
So on our three houses that had been sitting empty, we now
cash-flow $700 monthly and we will profit within 18 to 24
months, $227,900!

Now comes the best part. I finally put your class to the
test. I went out and found an owner who was willing to do a
lease option with me. Every realtor I spoke to (and many in-
vestors as well) told me no one in their right mind will do a
lease option with you in this market. The Florida market is
way too hot. They are right, it is hot. Appreciation in some of
our areas is anywhere from 34 to 40 percent.

But I got a gorgeous house that looks brand new, on a
lease option. I also got a killer deal on the rent at $950 a
month—normal rent would be $1,425! I put $5,000 down,
which will come off the purchase price. They were asking
$200,000 and it’s worth $239,000, so I offered them $210,000.
The terms are 14 months, enough time to refinance it if I have
to. My new tenants bought it on an 18-month term. We will
INTRODUCTION

cash-flow on a monthly basis $845 ($500 of that will be applied towards the purchase price), and we are selling it for $299,900. That is a profit of $89,900. Amazing—is this for real? I’ve since quit my job and I’m doing this full time. Thank you again, Wendy, for changing our lives!

Debra and Eric Larson

Why I Chose Real Estate

Deal making may just be in my blood. I’ve always loved a deal, and the day I realized that real estate investing was that kind of game was the most important day of my life. My first house was a three-bedroom bungalow in a suburb of Detroit. My principal, interest, taxes and insurance (PITI) was $438. I rented two bedrooms to two girls for $250 each. (By the way, both women are very good friends of mine to this day.) I had cash flow and I was living free! My $62 cash flow per month paid my credit card payment. I was 21 years old and I thought this was pretty cool! So I decided to do it again. I did it three more times that first year. I had no money or assets, but I did have good credit.

At the start of my real estate investing career, I was $20,000 in debt with student loans. In my mind, the worst thing that could have happened was that I would go bankrupt. However, I had good credit and was able to make my down payments on homes with credit cards. It wasn’t long before I had a credit line of over $250,000—and too many credit cards. Using credit cards should be the last resort for most investors, as I lost a lot of profit by having huge revolving credit card debt—even though I faithfully made payments on all of them and somehow juggled them so that no payment ever slipped through the cracks. It was, however, an administrative nightmare. Still, I couldn’t focus on that. I had to focus on what was the best that could happen: I could end up with freedom and choices!

When I started investing, I didn’t know about lease options or subject-to deals, and I thought what I did was a zero-down deal and something very creative. I didn’t know of any gurus at the time who focused on buying on lease options, so I developed my own tools and systems to buy homes with little or no money down, using the same techniques I was using to sell. I have since purchased almost every course available in the market on lease options, and learned extra tid-
Introduction

bits from them all to add to how I do my business. I am the only na-
tional educator in the country who teaches people how to work with
Realtors to find these types of zero-down deals. Over the years I have
fine-tuned the techniques that really work. I have completed hun-
dreds of lease option contracts.

I have bought and sold over 600 properties since becoming an
investor in 1985. I have had as many as 175 properties in inventory at
one time. My current and longer-term goal is to downsize to have 30
in inventory, not including partnerships with students around the
country. I have invested in several states and continue to look for new
opportunities throughout the country and possibly internationally.

Whether we leave a job to pursue our own dreams of becoming a
baker, a pilot, an artist, or a Realtor, we all have the same concerns and
fears about starting out in a new business venture where we have to rely
on our own efforts to make a payday. The first couple of years can be
rough. It takes a while to pay your dues in any new skill—and dealing in
real estate is a skill. But real estate not only has immediate profits
through lease options, it can also automatically provide investment in-
come by the very nature of appreciation. This appreciation factor isn't
built into most other self-employment situations. Real estate builds a
tangible future that can set you up for life if you have the passion and
the drive to dig in and overcome your fears of trying something new.

If you want to pursue real estate investing, and in particular lease options
or subject-tos, I don’t advise quitting your job and starting with nothing. In-
stead, I offer two pieces of advice:

1. It is best to start this business while you are still employed at your cur-
rent job so that you won’t have to worry about receiving a paycheck
while you are learning the business.

2. Begin to build a second income that can eventually replace your pri-
mary income when you are ready to leave your job.

Too many people leave their jobs too early, only to find out they have to go
back or can’t survive without the income. Don’t make that mistake.
INTRODUCTION

I am so glad I pursued my dreams in real estate many years ago. When I left corporate America in the mid-1990s to pursue real estate full time, it was the best career move I had ever made. It has given me financial freedom. Do you want to be free? Real estate can give you Future Financial Freedom (FX3) too!

This book shares my secrets and strategies with you. I suggest you try them all and decide what works best for your personal style and your specific area of the country. As you find your niche, you will perfect it. Real estate investing changed my life and it can change yours, too. May lease options, subject-tos, and zero-down strategies change the way you think and help you live out your dreams so that you may have all the choices and freedom you desire!
PART I

AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS
CHAPTER 1

How Lease Options and Subject-Tos Work and How They Can Set You Up for Future Financial Freedom (FX3)

What Are Lease Options and Subject-Tos?

Lease options and subject-tos are ways to purchase real estate, usually with very little or no money down, sometimes even with money back in the investor's pocket. Sound too good to be true? Well, it isn't. Can an investor end up with money in his pocket and not have to put 10 to 20 percent down to purchase real estate? Yes. These techniques are used commonly today by successful investors. This book will show you how to find motivated sellers and homes that you can purchase with little or no money down—truly the fastest way to Future Financial Freedom (FX3).

A lease option is a strategy that gives an investor the right to lease a home and also the right to purchase the home during or before the end of the lease period. An option is a contract that gives its purchaser the right to exercise a privilege. In the case of real estate investing, it gives the investor the right to purchase property during a contracted period of time. It is a technique that involves gaining control of a property without the added burdens of ownership. All money made in real estate is made by controlling property. Owning property is the most obvious way to control it, but control is possible without
ownership—and control is what brings in the money. It was a dying John D. Rockefeller who shared his secret to achieving great wealth: “Control everything, own nothing.” All of the most successful real estate developers today utilize options.

A subject-to is a technique by which the investor gains the title to a property but doesn't have to get a mortgage on the property he is about to control. The seller keeps the mortgage in his own name but deeds the property to the investor. It is deeded to a new owner “subject to” the existing mortgage, which stays in place with this technique. The mortgage company isn't usually made aware of the change or asked about the change. The new owner just starts making the payments on the old owner's loan.

It is important to be aware that there are some risks involved with either technique, and I cover these risks later in the book to help you minimize your exposure. The rewards that can come with either of these techniques far outweigh the risks, as long as you keep aware of all the factors involved. Real estate investing is perhaps the quickest and best way to build lasting wealth. Many of the world's wealthiest people acquire much of their wealth through investing in real estate.

While lease options and subject-tos can build you tremendous wealth, they usually shouldn't be considered a short-term investment strategy. I define a short-term strategy as one in which the time between the start of the transaction and its completion (cashing out) is less than one year. A classic example of this would be a rehabbing project (fixing up a home and reselling it). The other end of the spectrum would be a long-term strategy, such as buying a rental property and renting it over many years. I consider lease options and subject-tos to be in the center of that spectrum, usually requiring one to three years for the best payoff. However, you can always immediately sell the deal to another individual or investor for a profit; this is called wholesaling. It can be done if you buy the property at a low enough price that you can turn a profit by selling the deal to another investor where there is still enough room for them to profit as well.

**Visualize This Scenario**

In every seminar I teach, I ask the students, “Who of you would be willing to purchase a home valued at $200,000 for $100,000?” Of
course all hands shoot up. Then I continue by asking if they would still be willing to purchase the same home if the price was $150,000. Most of the hands stay up. I proceed upward with the price, increasing the increments by $10,000 each time. I always sit and watch with amazement as the hands slowly but surely drop. At the price of $180,000 almost all hands are down. At $190,000, usually, all hands in the room are down. The point I am trying to make to each of them is that most investors are not willing to pay this close to retail price for a home.

I then re-pose the question to each of them: “How many of you would be willing to pay $200,000 for a $200,000 house with no money down, in a market that is appreciating at 10 percent per year, with a 10-year period to pay the $200,000 to the seller at $1,000 per month?” Now all their hands go back up. I ask, “Why, now, are you willing to pay more for that house that you refused to pay $180,000 to $190,000 for a few minutes ago?” They respond in unison, saying, “Because you added some attractive terms!” My response is always the same: “You didn’t ask the terms before!”

Terms are part of a whole deal, such as price, length of time to pay, monthly payment, and other items negotiated with the seller, which are discussed in more detail in Chapters 5 and 9. Many times even experienced real estate investors don’t ask, “When does the seller need his cash?” They say “no” to a price without asking the seller when he needs the money. The previous example illustrates how most investors think: They don’t ask all the right questions about the property before they make a decision. They look at the surface but they don’t dig deeper for other possibilities.

Lease options provide a creative solution to allow you to negotiate terms that can increase your profits and provide a great investment opportunity. You are able to pay a higher price on a home if you can get reasonable terms, and having this tool at your disposal thus allows you to open up many new possibilities and make money on deals that were before completely ruled out. I am not suggesting that you pay $200,000 for a home worth $200,000, but you can if certain market conditions and terms previously described exist. If your market is flat (not appreciating) and you have only two years to exercise your option to buy the home, then maybe the price you offer should be much less. It’s all about terms!

When doing any lease option or subject-to deal, one of my mottos
is that everyone must win or we don’t do the deal. There are three people involved: the seller, the investor, and the tenant-buyer. It must be a win-win-win; otherwise, walk away.

Wendy’s Advice about Buying on Lease Option or Subject-To

If it isn’t a win-win-win for the seller, the investor, and the tenant-buyer, then walk away from the deal. There are plenty of deals out there where everyone can win.

Standard Lease Option Deals

My typical strategy is to lease option from a seller and then to lease option that home to a buyer.

How Lease Options Work

The above illustration depicts a sandwich lease option. In a sandwich the meat is in the middle—that’s the best part. You (the investor) are in the middle of this transaction; your reward is the meat—the difference between what you can pay for the home and what you can then sell it for. There are other ways to make this deal even better and more profitable, which are discussed in Chapters 5 and 9.

A variation of the sandwich lease is the lease purchase. While a lease option gives the investor the right to purchase real estate, the lease purchase guarantees that he or she will purchase the property during a given time period. Under some circumstances I will commit
to buying certain homes using this technique—for instance, with specific Realtors, with deals that have a very good potential for profitability, when I have a solid buyer lined up, with high appreciating markets, and with very long-term deals. I do not use lease purchases much when I’m selling, because they are hard to enforce. If your buyer defaults, you have to sue him specifically for nonperformance in order to get him to buy your home. It is costly and very time-consuming to do this. If your buyer cannot get a mortgage it is also a waste of time. I would recommend moving on and, in most cases, finding a new buyer. I therefore use lease purchases mostly to buy and rarely to sell.

**How Lease Options and Subject-Tos Work**

**Wendy’s Ethics Rule**

Don’t do lease options with potential buyers who have no way of ever being able to get a mortgage. That’s just being greedy and taking advantage of someone. It is not fair to the buyer. If the buyer messes up, shame on them! If you mess them up, shame on you!

**How Lease Purchases Work**

SELLER leases to sell

INVESTOR options to

BUYER (must buy) (may buy)

**Wendy’s Ethics Rule**

Don’t do lease purchases if you don’t intend to follow through on the transaction. Do what you say you will do, when you say you will do it. Help keep real estate investing an honest profession.
Standard Subject-To Deals

If I can't get a lease option or lease purchase from the seller, or if it doesn't make sense from a business perspective, then a subject-to is another way to acquire the property. However, it is important to note that a subject-to is a buying strategy only. Though I may acquire the property subject-to, I would still sell it on an option.

How Subject-Tos Work

SELLER | gives title to | INVESTOR (who now owns) | lease options to | BUYER (may buy)

A Lease Option Deal

Here's a great real-life example from my files of a lease option deal from start to finish—a true win-win-win:

The Seller: Janet

Janet, a seller, answered an ad I had placed in a newspaper:

Company looking for 3-4 homes in this area, on long-term lease. Call 123-222-2222.

Janet's home had been listed on the market for $189,000 with a Realtor and the contract had recently expired. She saw my ad and
decided to call me. She was exactly the kind of person I was looking for: willing to sell and also willing to do a long-term lease. I still had to determine some other factors to make sure it would be a win-win-win.

Janet’s most important area of concern was her price. It was set at $185,000, and she was not going to budge on that portion of the deal. As soon as I knew that Janet was set on this one area of negotiation, I could work with the other areas of the terms for myself (see Chapter 6 on negotiation). I would need to look at the rest of the terms to see if I could still make this a win-win for my side of the deal. These days I do not say no as quickly as I would have years ago; I look at the entire deal now, instead of getting caught up with a traditional style of price-alone deal structuring. Janet had fixed her price, and so I had to look at monthly payments and the time line available. By having all the facts, I was able to analyze the entire deal and thus make sure I would still obtain my bottom line of profitability.

At the time of this particular deal, we were in a strong appreciating market—approximately 6 to 7 percent per year. I figured that a 6 percent growth rate on $185,000 would mean approximately $10,000 per year just in appreciation. I had really hoped to get the property for $175,000. Even with the $10,000 in appreciation after the first year, I would still only be where I had originally wanted to be in the first place. I did end up buying the house and putting $4,000 of improvements into the property (basic carpet and paint). I now had $189,000 into the property, including the improvements. Anything above the $189,000 that I could sell it for would be pure profit.

Janet was not in trouble financially but she was motivated to sell. She had a severe shoulder injury that was preventing her from doing the maintenance around the property. She made great money and could have hired someone to do the maintenance, but she decided that with 20-plus surgeries under her belt and more to go, she just wanted some time off from dealing with her large home and yard. She didn’t need to pull her money out of the property, but she did ask for $1,000 up front so that she could go rent a lakefront home in the area. The $1,000 I gave her for the option fee, plus the $4,000 for improvements, was a total of $5,000 out of my pocket for this home, which is less than 3 percent down—a small amount for this home.
AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS

The Buyer: Roberta

I knew that Janet and I were going to come to terms and do the necessary paperwork on a Sunday, so I ran an ad on that same Sunday, and I got a call from Roberta. I told Roberta that she could drive by the home but that she could not go in or on the property yet, because someone still lived there. Roberta didn’t even know I didn’t have the deal tied up—I just wanted her to drive by and see if she liked it.

Roberta had credit problems and seven dogs. Most landlords will not rent to someone with seven dogs, and most mortgage lenders won’t do a mortgage for someone who has poor credit. With an inability to get a mortgage, she was also unable to work conventionally with a Realtor, so what was she going to do? No one would rent to her, and no one would give her a mortgage. Many people are in this kind of situation, seeking a solution. These are the people I am trying to help. They want the American dream, yet they are unable to obtain it in the usual way. Lease options give people a second chance to improve their credit while working toward the purchase of the home they desire to own.

If you’re a landlord, all you get up front on any of your rentals is the security deposit, and that is just not enough cash to take on the risk of someone with poor credit and seven dogs. You can change this scenario by converting these people from tenants to tenant-buyers; then the risk that once was on you is shifted to the tenant-buyer, which is where you want it. With Roberta putting a lot of money down (option fees are not refundable), she was taking on the risk.

Let’s look at how the deal transpired:

My out-of-pocket costs:

Option fee to seller \(-$ 1,000\)
Improvements \(-$ 4,000\)
Option fee from Roberta \(+$10,000\)
Left over in my pocket \(+$ 5,000\)

Without even owning this home I now had $5,000 in my pocket. Roberta was the one risking $10,000 with her option fee, as
it was nonrefundable. If she didn’t buy, she’d walk away from a lot of money.

Janet asked me for $1,100 per month for rent, and I in turn asked Roberta for $1,450 per month for rent. That way I was able to have cash flow of $350 per month, which would add to my profitability in the deal. In this case Janet had a lot of equity in the home, and I was able to leverage that equity to get her to accept the lower monthly payment of $1,100.

The option sale price I set for Roberta was $225,000. How did I get that figure? I put a 10 percent option premium on top of the retail price (see Chapter 5), plus I added an additional 6 to 7 percent appreciation rate at 18 months, which was approximately another $20,000. I then rounded it up a little to get to $225,000.

What was the property actually worth? Value is always determined by what a buyer is willing to pay. Roberta later had the house appraised at $267,000. Did I lose $42,000? I don’t think so. After all, I did make about that much. Was Roberta happy with the appraisal? Of course! Janet was happy because she got the price she wanted, and Roberta was happy because the appraisal gave her an additional $42,000 in equity that she can utilize if she wants. Janet won, Roberta won, and I won. This demonstrates what a classic win-win-win deal is all about.

Here’s my profit at closing—not bad for not actually owning the home (except for two hours), but just controlling it!

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Front-end cash</td>
<td>$5,000</td>
</tr>
<tr>
<td>Back-end sale</td>
<td>$31,000</td>
</tr>
<tr>
<td>Tax prorations</td>
<td>$2,800</td>
</tr>
<tr>
<td>$350 cash flow × 14 months</td>
<td>$4,900</td>
</tr>
<tr>
<td>Total profit</td>
<td>$43,700*</td>
</tr>
</tbody>
</table>

*It is not exactly $43,700. There are transfer fees in most states, title insurance fees, and I give my buyers option credits each month when they pay their rent on time. The extra $2,800 on tax prorations was given as extra profit to me also—a bonus when both the buyer and the seller paid for property taxes at closing. Only one person needed to pay for property taxes; therefore, the extra $2,800 is given to the investor in the middle of the sandwich lease option deal.
Here’s a great real-life example of a subject-to deal from start to finish, another win-win-win.

**The Sellers: John and Sally**

John and Sally, sellers, answered an ad in a West Palm Beach newspaper, from one of my ads that my student—I’ll call him Bob—used. I helped Bob structure the lease option portion of this deal to make the numbers work. Here is the ad:

Tired of monthly payments? We can help. We will make your payments. Call today. Call 123-222-2222.

The sellers were three months behind on payments of $2,100 each. They saw the ad and called. Their house was worth between $385,000 and $400,000. They owed $268,000 on the first mortgage, which didn’t include the three missed payments (one of which was only two days late); a second mortgage of $15,000; and a small assessment fee of $2,000, which could be paid at closing in a year or two. Total owed on the home $285,000 (not including those back payments). These sellers had attempted to sell this home twice in the West Palm Beach market, but both buyers had backed out prior to closing. They had since moved out and rented a place in a better school district for $2,200 per month. They didn’t have any savings and could not afford both payments. The home was in pristine condition and needed nothing, unlike many homes in this situation.

These people wanted to work out a deal so that they would be able to get some of their equity out and not lose it all. They wanted to get their equity when their current one-year lease expired so that they could buy a home in the new school district, but they didn’t need the equity out immediately. These people were also in a bad situation: They couldn’t refinance the property, even with their equity, because with the missed payments they no longer qualified financially for a mortgage; they had no one they could borrow from. These people were in a difficult situation, which required a solution.

An ad like ours will attract some lease option sellers but also
subject-to sellers; this particular couple was a subject-to seller. They were behind on payments. They were willing to take much less than the current value of the house, and to take it at a later date. They did not need their equity immediately. What they needed was a solution.

Bob offered to give the sellers $40,000 on their home, but not until he sold the property. There would be no interest on the $40,000. This would bring his total investment in the home to $331,000 (acquisition cost of $291,000 + $40,000). He also offered to make the three late payments that would bring their mortgage current—a total of approximately $6,300. From this point forward, he agreed to continue making their mortgage payments. This would prevent them from going into foreclosure. Their credit score would improve as he continued to make their house payments on time. While the late payments of 60 days on the mortgage were a negative indicator, they could be explained by the couple’s move and the two previous deals falling through.

Bob could have either made their payments until we refinanced the home into a lower rate or until he lease optioned it out. He had several choices. The biggest issue on this particular deal was the payment amount; it was a bit high for a rental, which many times can be a problem for subject-to deals. If the mortgage payment you are taking over is too high, you need to refinance the property at a lower rate or work out a better deal with the seller. On this particular home he lease optioned it out.

**The Buyer: Frank**

Bob found a tenant-buyer, Frank, with an ad for a lease option for the market rental rate of $1,600. The problem was that this rate left Bob $500 negative per month! He now had two choices: (1) See if Frank could pay more, or (2) do the refinance.

Bob and I came up with an offer that Frank couldn’t refuse: He offered Frank 50 percent on his investment (better than most investments). Frank was a high-tech type of guy who had credit issues from the year before when he had suddenly lost his job. Since then he had become reemployed and was making very good money. He could easily afford the payment and more. Bob offered to give him an extra $500 credit plus an additional $250 credit if he paid $2,100 instead of $1,600 per month. He jumped at it. The most it would cost Bob is $750 per month for the 12 months Frank was in the home, if he bought it. If he didn’t buy, it would make Bob the $500 per month
AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS

cash flow, which he could keep, and because he would not have to refinance he avoided the costs related to that. Frank also had $8,000 to put down as his option fee. He would have liked to put more down, but that was all he had saved since he had been so recently out of work.

Let's examine expenses so far:

Investor's out-of-pocket costs:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Three months of payments</td>
<td>-$6,300</td>
</tr>
<tr>
<td>Improvements</td>
<td>-$0</td>
</tr>
<tr>
<td>Option fee from Frank</td>
<td>+$8,000</td>
</tr>
<tr>
<td>Left over in our pocket</td>
<td>+$1,700</td>
</tr>
</tbody>
</table>

Bob didn’t even own this home but already he had $1,700 in his pocket. Frank was the one risking the $8,000 option fee because it's nonrefundable. If he didn’t buy, he’d walk away from a lot of money.

The option sale price we set for Frank was $425,900. How did we get that figure? Bob put a 5 percent option premium on top of the retail price (he started at $385,000 on this one, but it could have been higher—see Chapter 5 about determining the profitability of deals), plus an additional 5 percent appreciation rate at 12 months, which was approximately another $20,000. This was a very conservative appreciation rate for that market. I think he should have gone higher on the appreciation calculation. The appreciation rate at the time he sold the home was 10 to 15 percent in his area. This deal was very good on that account; I just did not like the monthly payment left from the owners’ mortgage.

Here is the profit at closing—not bad for not getting a mortgage on a deal and putting only $2,500 down! I wish all of my deals could be so profitable!

Front-end cash $1,700
Back-end sale 417,900 (less $8,000
($425,900 – $8,000) Frank put down)
Option fee credits given away
($750/month × 12 months) -9,000
Cash flow (break-even) 0
**How Lease Options and Subject-Tos Work**

<table>
<thead>
<tr>
<th>What Bob owed owner/lender</th>
<th>324,600</th>
</tr>
</thead>
<tbody>
<tr>
<td>($331,000–$6,400 paid)</td>
<td></td>
</tr>
<tr>
<td>Total profit</td>
<td>$86,000*</td>
</tr>
</tbody>
</table>

The sellers in this example were thrilled that their credit rating was improved and restored, so they could once again buy a home. The purchaser was also thrilled that he could buy a home in a beautiful town and restore his credit. This is another classic example of a win-win-win.

Not all subject-to deals or lease option deals are that profitable. It depends on where you start with the seller, how motivated they are, how strong the market is (appreciation), and the price range of the home. If you’re looking at a $50,000 home versus a $500,000 one, 10 percent makes a huge difference. The starting number will have a big impact on the total profitability. This is discussed further in Chapter 5.

**Financial Freedom—You Can Get There!**

These examples show you how lease options and subject-tos can be very profitable. The previous examples are fairly simple versions of the lease option and subject-to techniques, as there are many other creative ideas you can do to make them as profitable and complex as you choose (covered in Chapter 9). Remember, you may need several deals just to lay the groundwork for your Future Financial Freedom (FX3). It doesn’t happen with one deal, and it doesn’t happen overnight. However, with persistence it will happen!

There are at least three paydays using these techniques:

1. The upfront option fee from your buyer—or anything that your seller pays you to take over a mortgage on a subject-to deal.

*It is not exactly $86,000. There are transfer fees in most states as well as title insurance fees; principal paid on the mortgage during this time period is also kept on a subject-to.
2. The monthly cash flow—the difference between what you pay a seller and what your buyer pays you.

3. The back end—the difference between what you are paying for the home and what you sell it for.

While the option fee is nonrefundable, don’t get excited on your first deal by immediately going out and buying that big-screen TV you’ve always wanted. What if something happens six months down the road? In owning or controlling real estate, things come up that are completely unexpected: broken furnaces, leaking roofs, unpaid rents, and so on. Plan ahead for those things and you will be safe. If you have held the option funds in reserve, you will be able to cover your expenses. That’s just good business sense. Yes, the money is yours to keep, but be wise with it because you may need it. You might want to put it aside entirely for an investor’s rainy day so that you will be prepared. After the deal closes, you can take another look at the money, because you will have not only that initial option fee but also the back end from the closing.

As you are getting started in this business or any other business, it is important to be conservative with your cash flow and money. I recommend you keep your spending very tight and conservative. Also, you want to be prepared to buy the next property should a good deal be offered to you. Unfortunately, most people in our country do not have good spending habits, and these bad habits allow people to get into financial trouble. It is very important to be on a strict budget for this type of business. If this will be hard for you, then you may want to find some outside help to get you on a system, which can assist you in financial counseling. I cannot stress this enough; it can be a make or break for people!

Let’s say you made $30,000 overall on the deal. One positive way to use that money is to reinvest. Reinvestment will continue to bring income, but you will also want to pyramid your income. For example, if your first property made $30,000 overall and you received $5,000 in an up-front option fee, now you’re going to want to look for two to three new properties, probably with the same profit ranges. You’ll need money up front to pay your option fee to the seller, even though you will reimburse yourself later with the option fees from the buyer. The properties may also need repairs, and that money will have to
How Lease Options and Subject-Tos Work

come out of your pocket up front, so you need to have the funds available from the previous sale. During this time you will probably still keep your day job, just to keep enough cash flowing in while you are building your new business.

Reinvesting doesn't just mean pouring money into new properties. It can also mean purchasing new office equipment, software, or anything else you need to continue to build your business. Maybe it's time you trashed that clunker computer and got one that was made in the twenty-first century. Install a second phone line or buy bookkeeping software. I cannot stress it enough: Be prepared for your future.

At this time, my average profit is $40,000 per lease option deal. Lease options typically turn over every 12 to 24 months. Depending on what part of the country you reside in, the profit range should vary from $20,000 to $150,000 (Midwest to northern California). Subject-to profit ranges should be equal to or greater than lease options, because you are buying from distressed sellers and might be able to negotiate more on the price; however, you might also have to use more cash to purchase them. You decide how much you need to make, and then you will know how many homes you need to lease option or buy subject-to. Not only can lease options and subject-tos set you up to live well today, but they can set you up for Future Financial Freedom (FX3) and retirement. Just sit back and imagine . . . how would it feel to be completely debt free? Real estate is the vehicle that can allow you to achieve just that.
The best part of doing subject-to and lease option deals is being able to witness the end results. Unless a deal is a win for each party, walk away from it. The seller must win, the investor in the middle must win, and the tenant-buyer must win. When all three of these people win in a transaction, there is nothing better! This chapter contains stories shared by different investors in different parts of the country. The sellers’ and buyers’ names have been changed, but the numbers and details reflect the specific transactions. These deals will inspire you and show you how you, too, can be successful and create unique solutions for motivated sellers.

Lease Option Case: Steve’s First Deal

This study is important because it describes a first deal. I like it because it highlights how each party to the transaction was able to come away as a winner. Here is how Steve described it:

Sara had a house in Fowlerville that she kept after her divorce. She couldn’t stand to continue living with the memories from the marriage, so she bought another house in
Fenton, closer to where she works. She advertised the house as both “For Sale by Owner” and “For Rent.” She wasn’t excited about being a landlord, but she was looking for debt relief in a quick way.

I called on her “For Rent” ad and we met to discuss some options. I agreed to start paying her $1,100 per month immediately (because that is what she needed to cover her expenses), and for $1,000 I bought an option to buy her home at $155,000 sometime within the next three years.

I put about $300 into the house to fix a few things, plus I paid for a home inspection and a title search, so my costs were minimal, around $500.

Two days after I signed with the owner, a tenant-buyer from my accumulated list paid me an option fee of $5,000 and the first month’s rent of $1,195 to move in. The lease term was 18 months and the buyout was $169,900. There was no lease money being applied to the purchase price. The lease started in March and they have been paying early every single month. They have never called me with an issue of any kind, so it is going about as smoothly as I could ever hope.

I liked this deal because the owner was very happy that I took the house off of her hands, and she always receives rent from me by the first of the month. The tenant-buyers were very happy because they were able to get themselves and their three children from an apartment into a nice house on an acre of land. This is a “win” for me also because I made money on the front end, $95 monthly cash flow, and the whole deal will make over $16,000. Not bad for my first deal.

—Steve Giroux, Michigan

Lease Option Case:
Rance and Ryan’s Buyers Provide Cookies

This is a fun story from two of my students who got off to a great start on their first lease option deal. They did such a great job that their buyer has bought additional properties from them and even sends them Christmas cards and cookies! Here’s how they told it:
We attended your seminar on lease options in Seattle. Within one week of your seminar, we located a vacant rental in a nice Seattle neighborhood and were able to negotiate a lease option with the seller. We put the home under contract to purchase it for her full asking price of $175,000. We were willing to pay $190,000 but did not need to go that high. We were to pay $1,000 down, payable in 90 days or when we found a tenant. We paid no interest, with 100 percent of our $900 monthly payment going towards principal reduction. We had three years to cash her out.

We sold it on a one-year lease option in about 10 days for $200,000. That was a great deal for our buyers. We’re confident we could have sold it for $220,000. We took $10,000 down, leaving us $9,000 after paying the $1,000 to our seller. We received $1,295 a month from our tenants with no rent credit and none going toward reducing their principal. We got a $395 per month positive cash flow for one year that added up to $4,740 plus $25,800 after one year when our tenants exercised their option.

After making $30,540 on our first deal using the strategies you taught us at a half-day seminar, we signed up for your next three-day Lease Option Boot Camp and ended up acquiring 19 more properties the following year; two of them were clients referred to us by our first buyers, who have now acquired two more properties from us. Our buyers still send Christmas cards and cookies and continue to thank us for helping them buy a home when no one would loan them money because of a previous bankruptcy.

Thank you for sharing your lease option strategy and inspiring us to jump out of our comfort zones.

—Rance and Ryan Barclay, Washington

AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS

Lease Option Case:
Shaun Reaps What He Sows

This is an interesting case that shows the value of establishing relationships with Realtors. Shaun got a call from a Realtor that he had spoken
Success Stories of Buying on Subject-Tos and Lease Options

to over a year earlier; she had kept his card. This particular house had been listed for six months without luck. The seller had moved out of state, leaving the home empty for the past four months. Shaun was able to lock in very flexible terms to create a terrific deal for himself while relieving the seller of his burden and allowing a new buyer a fresh start.

This deal came as a referral from one of the Realtors that I talked to over a year ago. She called me out of the blue from my card she had kept. Here are the numbers:

- $700 per month  Lease option price from seller
- $850 per month  Lease option price to buyer
- $150 per month  Profit on cash flow
- $132,000  Purchase price from seller (for as long as I want—I can buy this house for this price in a month or in 10 years; he didn’t care either way)
- $159,000  Sales price to buyer within 24 months

I also got a $7,000 option fee from the lady up front.

Not a bad deal, huh? This is almost a $30,000 deal. The great thing about it is that the buyer has pretty decent credit. She could qualify for a loan on this property right now if she wanted to, but is going to wait about a year to get her score up from a previous divorce (her husband had a few late pays). Not only that, but if she doesn’t pay me, it’s no big deal. I’ll just do this whole thing all over again. I also negotiated with the seller that if for any reason I have a tenant who stops paying me, I don’t have to make payments until I get another tenant in the property.

This property was listed on the MLS for six months at $155,000 with no luck. The fact that I offered it on a lease option and had a pretty good marketing plan allowed me to get more than a Realtor could get. The house was in great overall condition—it was just a little bit outdated compared to the rest of the neighborhood. The seller had moved to Texas and it was sitting empty for four of those six months, so he was obviously motivated.
Thanks for showing me the ropes on this one, Wendy! My fiancée moved here from Kansas City about four months ago and immediately started the real estate biz with me. I love it!

—Shaun McClosky, Missouri

Lease Purchase Case:
Cleberto Has Multiple Exits

This situation shows that even though Cleberto had an exit in mind when he bought the property, market conditions in combination with the nature of buying on a lease opened up additional opportunities. Cleberto found a property listed with a Realtor. It was in a nice area of Orlando, where he holds most of his properties. He has a good understanding of the market and home prices there. Recognizing the below-market price per square foot, he followed up on the property.

It was a seven-year-old home in a nice gated community in Orlando. It had been listed for two months at $339,000. The following drew our attention:

- The price per square foot was below the subdivision average.
- MLS remarks: Motivated seller, $2,000 bonus.

Driving by the property, we noticed a recent “For Rent” sign. Now it was becoming really attractive. We figured the owners must need some cash flow soon, and we wrote our offer accordingly.

After some negotiation, the following was accepted:

- A lease purchase at the $339,000 full price (to get their attention) for a two-year term.
- We would advance three months rent and $2,000 of the listing agent’s commission (towards purchase price). These two items would be payable to the owners within 60 days.
- $500 in escrow (toward first month’s rent).
Success Stories of Buying on Subject-Tos and Lease Options

- Rent of $1,895.
- We also requested that the $2,000 bonus offered by the owners be paid to the listing agent (that way the agent would have $4,000 of his commission paid soon).

We had previously experienced problems taking too long to rent or rent-to-own a property, and had decided for this one to have a fallback plan, in case it was taking too long to market. Our lease option plan to find a buyer was as follows:

- Rent $1,995 (to move it fast).
- Option fee of $10,000.
- Price: $379,000 for a 12-month term or $389,000 for an 18-month term. This should give us a profit of more than $35,000 and $45,000 for the 12- and 18-month periods, respectively.

To our surprise, along came someone offering us $2,295 for a straight 12-month lease. We accepted it because it increased our monthly cash flow to $400/month, and there was an uptrend in our real estate market. We believed that trend would continue over the next couple of years.

As the end of the current 12-month lease with our tenant approaches, the market has experienced the tremendous appreciation that we expected. At this point, these are some of the alternatives we are considering:

- Sell this property for at least $390,000 and realize more than $40,000 in profit. Comparables are already there to support the price.
- Put it back on the market as a lease option with a price increase of some $40,000, providing a future $70,000 or more in profit.
- Buy it early from the owners and hold it longer. Since we would be closing earlier, we may request some breaks from them.

—Cleberto Copetti, Florida
AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS

Subject-To Case: Scott Finds a Deal

Scott describes his transaction in terms of the numbers as well as the paperwork involved in this subject-to deal. He goes on to tell of his lease option exit with another investor. Other investors can be your best sources of deals as well as your best customers. Keep your eyes open and stay creative.

The owners bought the home new for $155,000. They had paid the mortgage down to $150,000 when we bought it subject-to. The deal was as follows.

The purchase price was $150,000 (we took over the loan subject to a 6 percent interest rate). In addition, we gave them a check for $1,500 upon signing the warranty deed and we'll give them another $3,500 when the house sells with a new mortgage. We had them sign a warranty deed (notarized), seller's acknowledgment agreement (two-page disclaimer that they initial), a due on sale acknowledgment (telling them that the property is taken subject to the existing financing and could be called), a notarized general power of attorney, and a purchase and sale agreement. We recorded the warranty deed and now own the house.

Scott offered the sellers $3,500 at the point in the future when the house closes. His objective was to provide them with additional incentive to follow through with the closing. He goes on to describe the sell side to another investor. Because of the fast appreciation in this particular market, he negotiated a slice of that beyond the profit that he locked in at the time.

Within one month of doing the deal, a slightly smaller house sold in the same community for $205,000.

We sold this property on a lease option, using your techniques, to another investor for two years with $3,000 down, a positive monthly cash flow of $150, and a sales price of $188,000. We will also receive 25 percent of anything above the $188,000 that the investor sells it for.

—Scott Teerink, Arizona
Success Stories of Buying on Subject-Tos and Lease Options

**Subject-To Case:**
**Marti Helps a First-Time Buyer**

This next case shows how an investor was able to use the subject-to approach to create happy and satisfied buyers and sellers while creating a nice profit for herself.

In June a couple responded to my ad and asked what they needed to do for me to make their house go away. They had bought it on land contract, and when they moved they wanted to give someone else the same opportunity that they had. So they tried renting it with the option, but even the fourth renter with $11,000 down (from an insurance settlement) didn’t work out. They’d had enough. It was a mess. They took out 2,000 pounds of trash and cleaned it from top to bottom, so we wouldn’t have a reason not to take it.

We took the deed (their idea!) on November 19, leased it to a tenant-buyer on December 15, and evicted him on February 29. My renters from South Bend moved in the same day with the idea of buying it on lease option. However, on March 30 we had cleaned up their credit enough that we closed their loan. The balance on the mortgage was $46,000. We sold it for $75,000, having put $4,836.64 into the rehab, holding, and my closing costs. It appraised for $78,000. The buyers needed help with their down payment and closing costs, so they paid $78,000 which covered both. My net profit was $28,037.77.

The sellers’ nightmare ended and the buyers’ dream began, and we made money in the process! The buyers had been married 16 years and had always rented because no one had showed them how they could own a home. What was really great was that no one in the husband’s family had ever owned a home. Don’t you just love this business? Too cool!

—Marti Bentley, Indiana

**Subject-To Case: John Partners**

This next case shows how an investor got over the hurdle of completing his first deal by partnering with someone else. You don’t have to
do everything yourself. John found a good deal and shared it with some people at his local investors club. John worked with one of the investors who expressed interest in the deal. Together they negotiated the transaction, remodeled the home, and then sold it for a generous profit that they were happy to divide.

I was excited that Monday when we came back from Wendy Patton’s March seminar with other speakers in Houston.

I caught up on all my work and then went to the newspaper recycling pile for the classifieds. We marked everything that was interesting and after class started calling. One house was listed way below the property tax appraisal and in a decent part of town.

I got a ride to look at it, and then went to a small group meeting that the local investors club had that same night. When we talked about it, three people immediately asked to buy it. The first to speak, Kerry, signed an offer and negotiated a good price.

Six weeks later we sold it to the same contractor we used for remodeling.

Our profit, net of all costs including interest, closing, insurance, contractors, and everything else, was almost $30,000. Fidelity Title Company gave me a check for $13,845.01.

The contractor himself made another $30,000 after he finished it and retailed it through MLS a few months later.

—John Ward, Texas

Subject-To Case:
Lyle Uses Creativity and Flexibility

This next case is interesting in the various lessons that are displayed. It shows how Lyle was able to help someone even when it didn’t appear to be a great deal for him personally. It highlights how investors can frequently solve a seller’s problem creatively where it doesn’t make sense for a Realtor to list. It also shows that the first tenant-buyer won’t always be the one to conclude the deal. Each deal takes creativity and flexibility from beginning to end.
Success Stories of Buying on Subject-Tos and Lease Options

I received a call from a Realtor I know who had a friend going through a divorce with a small child involved. Since this seller had no equity in the property, my friend was unable to help her, so she brought me in, hoping we could find a creative solution to this dilemma. We paid her $500 to help with moving expenses—she was moving back home to her parents. These were the numbers:

- First mortgage balance $109,000
- Second mortgage balance $26,000
- Total encumbrance $135,000
- Arrearages $4,200
- Cash to seller $500
- Repairs $500
- Fair market value $144,000
- Gross equity spread $3,800

The only reason we did this deal was I made the mistake of letting my heart think, not my head. It was very thin, but I felt bad for her and her daughter. If we could help her, even without any profit, we would be doing a good deed. The home was only about four years old and needed nothing other than a good exterior cleanup and carpet cleaning with minor paint touch-up in the interior. We were able to take over subject-to, with no guarantees we could save it from foreclosure. We put it in writing that we would do the best we could, but no payments would be made until we found a buyer.

Lyle was not able to effectively use signs to advertise this house because of the homeowners association restrictions. By running a newspaper ad, he found a couple who wanted to buy on a lease option. The terms for his tenant-buyer were as follows:

- Purchase price (within two years): $149,900.
- Option fee: $5,000. The tenant-buyers paid Lyle $3,000 down and an extra $500 for four months. He applied all of this money toward the arrearages.
- Monthly rent: $1,495 with monthly cash flow of $50.
AN INTRODUCTION TO LEASE OPTIONS AND SUBJECT-TO DEALS

Lyle continues to the outcome of this case:

_This buyer was in the property for about 16 months when the husband lost his job. They knew the terms and they agreed to vacate the property peacefully, leaving all their money on the table. This is a very important point: Make sure you have good, strong paperwork for tenants. We went back in and cleaned up the property and decided to sell outright because our market had turned into a strong seller's market._

—Lyle Reichenbach, Arizona

Lyle's seller was able to rid herself of a difficult situation that would have required her to pay money out of her pocket in order to sell conventionally. She was able to avoid foreclosure and move on with her life. His tenant-buyers were able to build their credit as they worked toward owning a nice home that otherwise would not have been available to them.

Lyle was able to take control of a nice property and market it for very little cash out of pocket. He ultimately sold it for a profit of $28,000 after managing it for less than two years.

These stories are just a small sampling of transactions completed by investors who have used the techniques described in this book to raise their income levels while creatively solving problems for buyers and sellers. The first step in this rewarding process is finding motivated sellers. That's where we're heading in the next few chapters.

These people all started out exactly where you are. You can realize the same type of success and find the same types of deals. These success stories are from some of the hottest and strongest markets in the country, and these people have been successful with the techniques that you will learn about in this book. Congratulations on starting today toward Future Financial Freedom—FX3.
PART 2

STEPS TO BUYING PROPERTIES ON LEASE OPTIONS AND SUBJECT-TO DEALS
Finding Motivated Sellers for Lease Options and Subject-Tos

Motivated sellers are out there in every city, every town, every state. Finding a seller who will work with you on a lease option or subject-to isn’t as difficult as it might seem—if you know which techniques work to attract their attention.

I recommend looking for motivated sellers with nicer homes that require little or no work. This way you spend less time working on the house and less time working to find a good buyer. Also, I like to focus around the median price range and above. In my area of Michigan, the median price range is currently $170,000 to $180,000; therefore I have focused on the $150,000 to $300,000 range. These nicer homes are much easier to resell on lease options and generally much more profitable than less expensive homes. It’s also a lot more fun to work on nicer homes for more profit than on dumpy homes in rough areas for less profit—especially when you can buy the nice ones for little or no money down.

What Makes a Motivated Seller

A variety of circumstances and situations in people’s lives can make them need to sell their home. These can include a job transfer,
bankruptcy, foreclosure, upgrading to a bigger home, or a number of other reasons. However, the circumstances of the sellers may also be affected by the state of the two vying markets—buyers and sellers—which also affects their motivation. For real estate investors it is crucial to buy homes from truly motivated sellers—sellers who have an extra urgency, usually financial. You can’t get a good deal from an unmotivated seller who has no pressing reason to negotiate or give in on any part of a transaction.

There are different degrees of motivation and different reasons people need to sell their homes, but overall there are two basic categories of motivated sellers:

1. Desperate and distressed (bad debt)—someone in trouble financially, behind on payments, going in a bad direction, lost their job, going through a divorce, foreclosure, and so forth.

2. Not desperate or distressed (good debt)—someone not in trouble financially, not behind on payments, but motivated for other reasons: two house payments, inherited a home, burned-out landlord, job transfer, and so on.

Most real estate investors only go after the first category of sellers, but there is also huge profit potential with sellers that fall in the second category. Generally, lease option sellers should be people in the second category, while subject-to sellers will be part of the first category, though this is not a concrete rule. In this chapter we will discuss how to find motivated sellers of either type. In Chapter 4 you will learn the appropriate techniques to use for each kind of seller.

A final factor likely to affect a seller’s levels of motivation is the state of the economy itself.

**What You Need to Know about Buyer’s and Seller’s Markets**

The economy plays a big role in finding motivated sellers in different parts of the country. I discuss this further in Chapter 6, but for now it
Finding Motivated Sellers for Lease Options and Subject-Tos

is important to understand how the economy affects motivated sellers. First let's define these two terms:

1. A *buyer’s market* (weak market) is one in which real estate is not moving very quickly. There tends to be little or no appreciation, and possibly even depreciation. Sellers tend to be more open-minded about creative ways to sell their homes. There also tends to be higher unemployment in the surrounding area, and overall not a very good economy.

2. A *seller’s market* (strong market) is one in which available real estate is moving very quickly. There tends to be high appreciation. Sellers may be getting multiple offers in one day on their homes, and bidding wars are common. There tends to be a high employment rate in the surrounding area, great retirement/vacation facilities, and an overall good economy.

When the market is very strong, people are able to sell their homes more easily, even if they are in the “desperate and distressed” category. In a buyer’s market, it can be very difficult to sell a home. Yet, no matter whether it’s a buyer’s or seller’s market, motivated sellers are always available. You just need to look harder and you might find fewer in a strong seller’s market, whereas they’re much easier to find in a strong buyer’s market.

**Techniques for Finding Motivated Sellers**

The kind of motivation you are looking for is not just someone wanting to sell their house but someone who needs to get rid of their debt. These sellers won’t come knocking on your door, however, nor are they ever obvious. You must try several different approaches and determine what works best in your area. It’s a bit like fishing: Try a spot and a lure, and see if they work. If they don’t work, move to a different spot and try a new lure. Here are some tools that have worked for my students and me over the years:

- Bandit signs. These are the small signs you often see on street corners or telephone poles around your city. They are called
bandit signs because in many cities posting them is illegal and you can be fined, but investors still put them out and risk incurring a fine for the sake of the potential profit of a deal they may bring. The signs might say “Cash for Your Home,” “Stop Foreclosure,” or the like. One of the advantages of buying a house on a busy street is to be able to advertise with a bandit sign in your own yard, which is generally legal (check your city ordinances). An investor I know who owns 30 houses in a subdivision deliberately bought the one on the busy entrance corner so that she could advertise on the lawn and pull people back into the subdivision to look at the other houses. Many companies make these signs and they are not expensive, so if someone removes them or they blow away, it’s not a great loss.

- Advertisements in the newspaper. The way I usually find my sellers is either through ads they have placed in the paper or ads I have placed to fish them out. See the opposite page for several examples of ads that you can run that will attract sellers to call you. Experiment with different types of ads in your area, and also with different types of papers. You can try the smaller local papers, or the larger metropolitan area papers, depending on your budget and your target market. I have also placed ads in both the “for rent” section and the “for sale” section, depending on the ad.

- Tear-off flyers posted in public places like local drug stores, convenience stores, party stores—wherever you can get them posted. These flyers can say the same things as the signs and ads. The tear-off parts should have your phone number, your web address, and a short statement like “We Buy Houses.”

- Letters to Realtors. Inform Realtors about what type of homes you buy and how you can help them sell their listings. This is one of my favorite ways of finding deals. I currently find 90 to 95 percent of my lease option sellers through Realtors. I discuss this in more detail in Chapters 10 and 11.
Finding Motivated Sellers for Lease Options and Subject-Tos

Ads to Attract Motivated Sellers

Company looking for 3-4 homes in this area for long term lease. Call 123-456-7890.

This ad will draw in sellers who are considering something long term and those who want to rent their homes out. In other words, people who respond to this ad are ready to do the most important part of an option—lease—and to do it for a long period of time. This type of person does not need any cash out or they would not respond to this ad. The ones we’re looking for are those who have not been able to sell their home, so they are willing to consider the four-letter word: rent. At the end of this chapter is a script that I use when calling about “for rent” ads in the paper. Use the same script, but only after they call you.

Executive looking in this area for a lease-to-own nice home. Call (123) 456-7890.

This ad will draw in the people who own nicer homes and who will more likely be lease option sellers than subject-to sellers. Regarding the wording of the ad, we are executives in this business, right? I am, and hopefully you are too, so there is nothing dishonest in putting it this way. However, these sellers will naturally assume you are looking to live in the property yourself. Later, you will need to break the full facts to them slowly. This is covered in Chapter 6 in a discussion about handling sellers’ objections.

(Continued)
STEPS TO BUYING PROPERTIES

Home not selling? We can help! We buy and lease homes. Call (123) 456-7890.

This ad will bring in sellers who are starting to get very motivated. These may be people who are behind on payments or they may be getting motivated for other reasons. They could be either lease option or subject-to sellers.

Tired of monthly payments? We can help. Call today: (123) 456-7890.

This fourth ad brings in sellers who are behind on payments, threatened with foreclosure, and also people who have two house payments. It brings in sellers with both good debt and bad debt. This is a great ad to bring in both lease option and subject-to sellers.

Stop Foreclosure! Behind on payments? Don’t lose your equity. We can help! Call us today! (123) 456-7890

The last ad brings in sellers in foreclosure and much more desperate circumstances. It is definitely a stronger ad. This will be used to draw in subject-to sellers only, sellers with bad debt. We will only buy subject-to when a seller has bad debt—this is discussed in Chapter 4.
Finding Motivated Sellers for Lease Options and Subject-Tos

- Letters in response to “For Sale By Owner” (FSBO) postings. Many times FSBOs (individuals selling their home without the assistance of a Realtor) think it will be easy to sell their own home, but when they start to deal with buyers, lenders, title companies, and so on, it can become overwhelming, and they can start to get motivated to sell quickly. It is not always easy to sell by yourself. Many investors work with FSBOs (pronounced “fizz-bos”) in buying deals. According to the National Association of Realtors (NAR), in 2003 a FSBO typically sold for 20 percent less than if sold through a Realtor, so that’s a significant savings to the investor.

- School directories, church flyers or directories.

- Long-term Multiple Listing Service (MLS) listings. If you are not a Realtor, you can hire one to do a search for you of listings on the market over 90 or 120 days old. These sellers are getting motivated because their homes are taking too long to sell. Also have the Realtor check for all the expired listings.

- Business cards. Your card should say that you buy or lease homes and give information about how to reach you, including your web site, your fax number, and so forth.

- Out-of-state owners. Many cities have services that allow you to find all out-of-state owners, or houses where tax bills are sent to addresses other than the property itself (non-owner occupied). Because out-of-state owners are far away from their property, they may want to get rid of the faraway headache and move on with their life. Also, they may not really know what the current market is anymore.

- Vacant homes are an indication that someone is making a payment on a home that is not being used. Write the owner a letter. You can send it to the vacant house and hope it gets answered, or you can try to find the owner through the post office, through township tax rolls, or by hiring a private investigation skip-trace service. Skip-trace services are great ways to find not only potential sellers but, later, missing tenants who owe you rent. These searches can be fairly inexpensive—check around for a good company that gives good
prices and reliable service, and ask for a recommendation from a Realtor or a place that does background checks. You’ll start to hear a few names again and again, and you’ll be able to make an informed choice.

- Through real estate investor clubs you can find other investors with homes they haven’t sold and want to sell. Network and let others know what you do. I have bought several very good deals from other investors, either because they had their hands full at the time with their own deals, or the properties were out of their area. You should be a member of a local real estate investor club and regularly attend meetings. It is one of the best places to network.

- Corporate relocation departments have an inventory of homes that have not sold. If the company does not do a corporate buyout, the owners would be great candidates for a lease option. They have already relocated and need to have someone in that home and making payments.

- Your local chamber of commerce can tell you what businesses are leaving town, who is coming in, and so on. If you have many properties, they might also list you as a rental company and refer incoming people in the area to call you.

- Word of mouth. After you have been in this business and networked for a few years, you will start to find deals coming to you by word of mouth. Someone knows someone who knows that you buy homes. I have bought some of my most profitable homes by word of mouth.

**Motivated Landlords**

Landlords can be great motivated sellers, especially if they are burned out. If the economy is slow, they might have higher vacancies than in a fast or hot market. In my experience, I have found there are two basic types of burned-out landlords. The first type has watched a lot of late-night TV and decided to make millions in real estate. Unfortunately, many people buy real estate with no knowledge or experience, thinking they know it all after hearing a high-powered, adrenaline-rush
Finding Motivated Sellers for Lease Options and Subject-Tos

sales pitch. There are, however, many state and federal laws that regulate this business. This type of landlord will fall for the professional tenants and their stories and experience, and often end up getting burned. Understanding how to screen tenants and select them is key not only to being a good landlord, but also the business of selling by using lease options. By being a member of a local real estate group, you can get the education and assistance you need to be successful as an investor. If you want to find a group in your area you can check the National Real Estate Investors Association web site. See the Resources section in the back of this book for a group in your area.

The second type of landlord is more tired than burned. These landlords are retiring and ready to move on with their life. They don’t need the money from the sale of a home, and in many cases they don’t want to receive it yet. They usually have huge capital gains to contend with and may not want to pay those gains yet, or they may want to plan for a 1031 exchange.* By optioning their home to you, they might be able to better plan for a 1031 tax-deferred exchange. There are sellers who will sell to you on an option to avoid the taxes now but gain the benefits of renting their homes. With this solution they can benefit from cash flow and avoid the other issues of being a landlord that they don’t like or don’t have time for now.

When I purchase a home from a landlord, one of the benefits to him or her is that I usually completely assume the maintenance on the home, or ask them to assume only the first $500. I also take responsibility for the advertising, vacancies, showings, and so on. You can be very creative when structuring a deal with an owner of a home. The benefits for a landlord include but don’t have to be limited to:

- Maintenance. Sellers don’t have to deal with issues and calls. Even if they pay a portion of the costs, I handle the work.

* A 1031 exchange is an IRS section that allows a person to exchange their like-kind property for another property of equal or greater value, and therefore defer (not avoid) the capital gains on the first property. For instance, if a seller has a home that they bought 10 years ago for $80,000 and it is now worth $140,000, and they have depreciated the property from $80,000 down to $40,000, then they would need to realize a $100,000 gain ($140,000 value less the depreciated value of $40,000 equals $100,000 of gain). This would be a long-term capital gain, but with a 1031 the gain could be put off into the future.
**STEPS TO BUYING PROPERTIES**

- **Showings.** Sellers never have to show the home again. I do the showings, take the calls, and discuss the home with all prospective tenants.
- **On-time rent.** They don’t have to worry about the tenant paying each month. Their rent check comes from me, *regardless of whether the tenant has paid me on time.* My check is good and on time each month.
- **Advertising.** They don’t have to advertise the home anymore. I pay for all the advertising and handle all the calls.
- **Vacancies.** They don’t have to worry about vacancies anymore. I will pay whether the home is vacant or not. (You can negotiate this if the seller is willing—i.e., you have one month free rent in each X (any number you choose) months of the lease if you don’t have it occupied.
- **Insurance.** They have extra liability protection when they lease option to me. I carry a $1,000,000 liability policy on properties that I don’t own and am only optioning. This liability policy is really to protect me; however, if something really bad were to happen on this property, this insurance would be utilized in a defense, which would also protect the owner of the home.

These benefits alone will allow a landlord to feel comfortable with selling but also with taking in less rent than they usually charge. Talk about these benefits to help them see the advantage in leasing the home to you with an option. They now have fewer headaches, less overhead, and fewer fees and expenses, so they can afford to lease it for less. Because you are making a lower payment to the seller, you can also rent it to someone and have cash flow.

**How to Evaluate Seller Ads in the Newspaper**

Besides placing your own ads in the newspaper to attract sellers, you can also answer sellers’ ads. In lease options I find that most sellers need or want their cash out. The best way to find a seller for a lease option is not the FSBO section of the newspaper, but the “for rent” section. Your goal is to turn the landlord into a seller.
Finding Motivated Sellers for Lease Options and Subject-Tos

Wendy’s Tip

One trick to finding motivated sellers is to take the current real estate section of your newspaper and file it in your cabinet for a month. After a month, start calling those sellers. If their homes are still available, then they are getting more motivated. The longer a home sits, the more motivated they become.

The reason I don’t call on ads in the “for sale” section is that 90 percent of those sellers must get their cash out and most of the other 10 percent won’t consider something creative. It is not because they don’t want to consider something creative—they would just prefer to cash out and be done with the property. Also, trying something unique will scare most sellers. Call the ads that are for rent, because the two main obstacles have been resolved: These owners apparently do not need to sell or to cash out of the home, and they are obviously willing to lease it.

How to Navigate Successful First Contacts with Sellers

The most effective way to contact sellers is by calling them. Immediately tell them your name to start building rapport, and try to keep your voice calm and soft. Be sure to ask questions appropriate to the area you are calling. What is important to that part of the country? A basement? A pool? A fenced yard? A certain type of landscaping? Updated kitchens or bathrooms?

When you begin to regularly respond to seller ads, consider setting up another phone line, perhaps toll-free or even a voice mail box just for that particular house or ad. I prefer that callers reach a live person, so if they call my office they get someone live. If they call after hours, they get a referral to another number where they can get a live person. However, if this is not feasible for you, be sure to check messages frequently and return calls promptly.
The following script can be useful when calling the owner of a rental home. The words in italics are what you say to the owner. Don't waste the seller's time asking questions that are answered in the ad or from their opening description, but do ask questions applicable to your area of the country, such as whether it is in a flood area, whether it has central air, whether it has ever had termites or been in a fire, how old the roof is, and so on. Ask whatever might be of interest to you and find out as much as you can about the home.

Hi, my name is _________. I'm calling about your home for rent. Can you tell me if it is still available?

Giving your name sounds warmer and will help put the owner at ease with you. It is a great way to begin building rapport.

When is it available?
Can you tell me a little about the home?

Let them volunteer some information about the home or ask them to expand on some of the information in the ad. You are building rapport with the owner. Talk and let them talk. People warm up when they are the ones talking. Listen and sound interested.

When was the home built?

This question gives you an indication of any decorating or maintenance problems you might run into, such as whether it might need to be updated. If the house is older, ask the next question; if not, skip to the one after.

Have the kitchen and bath(s) been updated since it was built?

If it was built in the 1970s, I often ask if the baths or kitchens are yellow/green/brown or if they have been updated.

Does it have a garage or basement?
Is the yard fenced?

This may prompt them to ask whether you have pets. At this point they still think you are the one who will be living there. I don’t change that conception until enough rapport and trust have been developed. They may ask how many people will be living in the home. In such case I don’t want to lie but I don’t want to be totally direct either. If you say, “I don’t know, I am going to rent it to someone else,” you can be sure they will not show you the home. Each time these questions come up,
Finding Motivated Sellers for Lease Options and Subject-Tos

you will answer them differently, based on the owner. Here are three ways you could handle their questions:

1. Answer as if you really were going to live there.
2. Try to change the subject or slightly avoid the question.
3. Try to answer using your best guess of who might be renting from you later.

I am not recommending deliberate deception. I am very honest and straightforward with my sellers—but only after we meet in person or when I feel they are open to discussion about the entire situation. Because everything will eventually be in writing, they will know that you are not occupying the residence before they sign the documents.

If the home sounds like something you would like to own, then pop the question. If it doesn’t, just be polite and say you will call back later if you are interested.

**Wow, this home sounds really nice, would you considering selling it?**
If they say no, then say, “Thanks, but I am really looking for something I can buy.” Leave them your name and number so they can contact you later if they change their mind about selling.

**Do you know how much you would want for the home?**
Start to feel out the owner for the type of terms they would consider, but be careful not to make any verbal offers. This isn’t the time for negotiation—you are still just gathering information. Construct your offer later when you are not on the spot.

**When could I come and look at the home to see if I would be interested in it?**
Make arrangements to go as soon as possible. This shows the seller that you have more than casual interest in the property. Set an appointment and keep it. If you must change your schedule, be sure to let the seller know ahead of time and make alternate arrangements for as close to the original date as possible. This courtesy will also demonstrate your genuine interest.

You have now called sellers, had sellers call you, and perhaps you’ve accumulated some leads to pursue. Now it’s time to go look at the homes, continue to build rapport with the sellers, and gather more information. In the next chapter, you will learn more about which technique to use for each motivated seller you have found.
Acquiring investment real estate can be handled with many approaches. Two very popular zero-down approaches are lease options and subject-tos (also referred to as “getting the deed”).

A lease option is a technique that involves gaining control of a property, but not ownership—just the right to take responsibility for a property now and purchase that property at some future date with defined terms.

A subject-to involves getting the deed to a property without taking on a new mortgage. Instead, the seller signs over the deed to his home “subject to” the existing mortgage. The buyer makes the mortgage payments on the seller’s existing loan but does not take out a new mortgage to acquire the home.

Both of these techniques usually require little or no money down. In both, it is possible for the buyer to get money from the seller or the purchaser (or both) in the beginning of the transaction. These
techniques, when used properly, can result in large profits for the real estate investor. They are very effective individually and, when used hand-in-hand by investors, are almost an unbeatable pair!

Knowing when to use which technique is important. Many times, investors try to fit one technique into every situation, which can be a very dangerous approach. Choosing the right technique—lease option or subject-to—for your seller’s situation can save you tens of thousands of dollars and protect not only you but your tenant-buyer as well.

To make a wise choice, you must have a clear understanding of two critical factors:

1. What type of motivated seller you are dealing with.
2. The techniques of lease options and subject-tos and how they best suit your seller—and you.

**Know the Seller Situation**

Finding a motivated seller is the first step to any good real estate deal. We tend to think of motivated sellers as people who are financially distressed, but I like to look at motivation from a much wider range. I like to divide motivated sellers into two groups:

1. Sellers who have bad debt. Solution: Get the deed—no lease option.
2. Sellers who have good debt. Solution: lease option or get the deed.

Sellers who have bad debt are generally in trouble. They might be behind on a mortgage, out of a job, down with an illness, in the middle of a divorce, and so on. In these situations, you need to get the deed with either a subject-to or an outright purchase. Your main concern is that this type of seller may continue to have financial problems that could affect the title to the property if the deed is still in their name. For example, any judgments or debts against such a seller can attach to any real estate the seller owns—and those judgments or debts would have to be paid off before you could exercise your option to buy. That’s why you want to get this type of seller off of the title. Otherwise, their future problems could easily become your future problems.
Sellers who have good debt are not in trouble in the traditional sense, but they do have a reason motivating them to sell. Their problem is not financial desperation—it’s simply a change in their lives. They might be transferring to a new location for a promotion, getting married (each owning their own home), building a new home, burned out on being landlords, and so on.

Once you have determined what type of motivated seller you are dealing with, the next step is to determine which technique, lease option or subject-to, best suits both your own circumstances and those of the seller.

The rest of this chapter discusses the advantages of lease options and subject-tos, the risks of each, the types of sellers that will accept these techniques, the benefits to the sellers, and a comparison of the pros and cons of each strategy.

**Subject-To Advantages**

Subject-tos have at least eight advantages. Some are the same as with buying an option.

1. Minimum or zero down. Usually you only need to pay the seller a small amount to sign the deed over to you. It’s even possible that, if they owe more than you are willing to pay, they may pay you to take the deed from them.

2. No financing required. When you do a subject-to, you don’t need to get a mortgage because you are taking over the seller’s mortgage payments. Technically, you are not assuming the seller’s mortgage. You are just making the payments on their existing mortgage.

3. Ownership. The day the seller deeds the property to you it is yours. You are the true owner of the home.

4. No qualifying. If you buy a home traditionally, you have to go to a bank or mortgage company and qualify for a loan.

5. No income or credit checks. Not once has a seller ever asked to look at my income or check my credit. They are more worried about their situation and how to get help from you.
Lease Options versus Subject-Tos

6. You can buy them with your IRA. Very few companies handle self-directed IRAs. If you use your IRA for the option payment, the rent payment and any other income goes back into the IRA. Remember, the income from the Roth IRAs is tax-free for life. You can also do a subject-to with your IRA when there's a mortgage already in place.

7. Great return on your investment (ROI).

8. The seller will love you. You will be making a positive difference in someone's life.

Subject-To Risks and How to Avoid Them

The biggest controversy for a subject-to is the violation of the due on sale clause. This clause is a provision in the mortgage documents that says if the home is sold or transferred, the mortgage will be paid in full or the lender could call the loan due in full. This means that when the sellers deed the home to you, the lender can demand payment in full on the loan. However, most lenders will never know the seller transferred their title to you, as long as you make the payments on time. Most lenders are only concerned with receiving their regular loan payments in full and on time.

In a rare occurrence a lender, may for whatever reason, choose to call the loan due on a property transferred subject-to, instead of continuing to receive payments from an investor. You should disclose this risk to a seller and also be prepared to refinance the existing mortgage in the unlikely event that this happens. There is some speculation in the industry that many due on sale clauses have not been called because interest rates are currently low. If rates go up, then lenders will have a reason to call loans due: They will want to get the higher rates on these properties.

Most educators teach students to have the owner transfer title into a land trust, claiming this technique will bypass the due on sale issue altogether. Other educators believe that if the owner is putting the property into a land trust just to bypass the due on sale clause (i.e., covering up the breach of the due on sale clause), the transaction could later be considered mortgage fraud. Such educators think that you should be up-front with the lender and send them a
certified letter stating that you are taking the property and making the payments on loan. Most lenders will still not call the loan due (why trade payments for yet another foreclosure?). If the bank later tries to call the loan due, you can argue that they waived their right to foreclose by not calling the loan due up-front. Whichever approach you use, you should consult with a qualified attorney on the issue. The relevance of this issue may vary from state to state.

A land trust is roughly comparable to an entity, such as a limited liability company, except that it provides no liability protection. Like most trusts, there are generally three parties: the grantor, the trustee, and the beneficial owner. The grantor is the person who puts property into the trust. In the case of a subject-to, the seller is generally the grantor. The trustee is the person in whose name the trust's property is held. The trustee is also generally the person who administers the trust (e.g., signs deeds, pays taxes, etc.). The trustee is generally an individual. In most states, the beneficial owner of the trust can be the trustee of the land trust. The beneficial owner is the person who gets any payments or use of the property held by the trust. You or your company is normally the beneficial owner of a land trust in a subject-to transaction. In addition to making a breach of the due on sale clause less obvious, a land trust might prevent transfer fees or revenue stamps (the cost of transferring a deed) in many states. This cost can be many thousands of dollars in some states. Again, consult with a competent local attorney before using a land trust, because trust law varies from state to state. Also, as I mentioned, some experts do not advise concealing a breach of the due on sale clause. You and your attorney need to jointly weigh the benefits and risks of using land trusts.

Instead of a land trust, some investors use two insurance policies to help keep the deed transfer discreet. The lender generally won't know about a deed transfer unless someone tells them, and the way they often find out is when the insurance carrier notifies them of the change in ownership. Therefore, many investors keep two policies in force: first, the old homeowner's policy with the original seller, which really is not any good, since the seller no longer owns the home. Keeping this policy in place simply keeps that insurer from reporting a deed change. Second, the investor purchases a policy for himself, with the net result that he makes two insurance policy payments. Obviously, if you and your attorney decide that directly informing the
bank of the transfer is the best approach, there is no reason to keep
the original homeowner’s policy in force.

In my opinion, the best and most ethical way to handle a subject-
to deal is to be completely honest. Let the lender know you did it. Send the lender a certified letter informing them of the ownership change. Keep proof of the letter and return receipt in your files. If the lender doesn’t respond (most won’t), then the law may hold that they have accepted the change by ignoring your letter. If they try to foreclose, then you may need to pay off the existing mortgage and refinance the property into your own name. If the property doesn’t have enough equity to justify refinancing into your own name, then it probably was not a worthwhile deal to begin with.

You can also do nothing. Just do the subject-to and don’t tell anyone. Wait for the lender/mortgage company to notice or say something. Most loans are never called following a breach of the due on sale clause—but the risk is there.

The big risk of using a land trust to hide a due on sale transfer,
or of double-paying insurance for the same reason, is that if a court rules that the intent was to keep the bank from exercising its legitimate rights by hiding an important fact (the deed transfer), you can be accused of fraud. Telling the bank what you have done and being able to prove that you did so kills any chance of accusations that you hid the transaction. No deception, no fraud.

Another big controversy with subject-tos, and one reason I struggle ethically with them, is that many investors abuse them. I don’t like the paperwork I see on many of the subject-tos and I don’t like what I hear in the media. Subject-tos can be the most wonderful thing for some sellers, changing their life and saving their credit, but
unfortunately, they can also do the opposite. Much of the paperwork
that I see says, in effect, “Seller, you understand when you deed me
your home that I am not guaranteeing anything!” To me, it is dis-
stinctly unethical to take someone’s home without guaranteeing you
can make the payment. Such so-called investors can and do get crimi-
nally prosecuted for this, and I completely agree with such prosecu-
tion. Subject-tos can’t be done by mortgage brokers and Realtors in
some states because they violate the code of conduct and ethics.
These states feel that assisting a seller to violate or circumvent a con-
tract is wrong.

A subject-to can be a great way to buy property and to help
many sellers who might not otherwise be able to find help. Most in-
estors don’t mean to hurt a seller, they just get in over their heads.
They think that if a seller is willing to deed their home to them, it
must be a good deal. Well, it might not be a good deal—check out
Chapter 5 before you commit.

Wendy’s Ethics Advice on Subject-Tos

A subject-to can really help a seller if done right, by helping improve their
credit. If done wrong, it can mess up their life for a long time. Don’t do a
subject-to if you can’t commit to making the payments. Only do subject-
tos on what you can commit to, and then do what you say you will do!
Only do the deal if the deal is worth doing. If you are unlikely to make a
profit, you are more likely to do the wrong thing and default on your
solemn promise to the seller.

So what else can I do besides a subject-to when I find a subject-
to type of seller? I have three choices (the third is available only to li-
censed Realtors):

1. I can buy the home outright. I must get the deed, but I don’t
have to do a subject-to in order to get the deed. I can simply purchase
the home, either for cash or by getting a mortgage. But because the
seller does not fit the lease option technique, I must get the deed.
Lease Options versus Subject-Tos

2. If the deal is very good, and I know it fits into a subject-to and not a lease option, I can wholesale the deal to another investor. Wholesale means buying very low and selling low. I might sell it for a profit of $3,000 to $10,000 without ever having owned it. Normally I would choose the preceding option, but this one is a great choice for those who want quick cash. You can always find buyers for good deals at your local real estate meetings. Get a buyers list together if you want to wholesale your leads. You can wholesale both lease option and subject-to leads. Normally in a wholesale you sign a contract and then do an assignment of the contract. For example, I would tell an investor, “I have a lead, and for $XXX I will pass it on to you.” I would sell the lead, rather than signing on a contract for the deal. Be sure to talk with a competent local attorney, so you can structure your wholesale deal to not run afoul of local real estate brokering statutes.

3. I can also list the home for the seller and get a commission, if the seller has time to stay in the selling process. However, I rarely do this. Although I am licensed to sell real estate, I normally do not do retail real estate. I prefer to buy and sell real estate for investments and not as a broker for others. Also, many sellers don’t have the time to wait for a sale to complete if they have financial problems.

Lease Option Advantages

A lease option has at least seven advantages:

1. Minimum or zero down. Whether you are buying from owners directly or through Realtors, there is little or no money required to buy on options.

2. Little or no risk. If you’re buying a house on an option, you also maintain the right not to buy it. This, to me, is the best benefit of lease options. If the market goes up you can buy; if it goes down, you don’t have to buy. It’s your choice. If you own the home you don’t have this choice—you can’t just give it back to the bank. And with a subject-to you can’t change your mind later, because you own it.

3. Monthly payment amount (rent paid to owner) is significantly less than a mortgage payment. Typically, I like to get a rental
payment for 0.5 to 0.6 percent of the value of the home per month. On a $200,000 home, that's $1,000 to $1,200 per month. If you can get that deal, you can get cash flow almost anywhere in the country. Unless you put a lot down on a mortgage, non-owner occupied mortgage payments will be closer to 1 percent per month for the same property (depending on mortgage programs and rates at the time). For instance, on a lease option the owner might owe $100,000 on a home that they lease optioned to me for $200,000 and their payment might only be $800 for principal, interest, taxes, and insurance (PITI). On a subject-to deal, it would not be nearly that low. The seller would not normally deed the home over if they only owed $100,000. In most cases they would owe more and the payment would be higher; therefore the investor would also be paying a higher monthly payment and not receiving as much cash flow.

4. No qualifying. In most cases you will never have anyone ask you for your income or credit information. This is done by building rapport with the seller or the Realtor (discussed in Chapter 6).

5. Great return on investment. The return on investment should be infinite in most cases, because in most cases you would be putting little or nothing down and getting a return and profit.

6. You can buy them with your IRA. You can buy lease options and subject-tos in your IRA. You must have a company that knows how to legally and properly invest and self-direct real estate through your IRA. I use Equity Trust, out of Ohio.

7. The seller will love you. The seller will be thrilled that you helped them with their situation. They won't be able to thank you enough if you looked for a solution that was a win-win. You must be fair.

**Lease Option Risks and How to Avoid Them**

The biggest risk for a lease option is the possibility of the seller having a problem financially. Although in the beginning we only lease option
from financially strong sellers, there are things that could go wrong in a seller's life. A lease option is control without ownership. Because the owner still holds the deed or title to the property, if they incur a financial problem, there is a chance the title/deed could have a lien placed on it. A lien can usually be placed on a piece of real estate if a person owes someone money, when certain procedures are followed. This may cause a problem such that it may not be possible for the seller to sell the home easily. This would be horrible not only for you, the investor, but also for your tenant-buyer. Fortunately, there are several things you can do to assist in preventing the repercussions of these things on you as the buyer.

First, make sure the seller is solid when doing a lease option with them. If they want to check your credit, ask to check theirs too. I have never checked any of my sellers’ credit, but it is not a bad idea. You can also have a private investigator check them out if you are not sure. Find out where they are moving. Is it a better home? More expensive? Then you will know if they are moving up or down.

Second, make sure you record a memorandum of option. This is a document that gives the world notice that you have an interest in the property. Then the seller can’t refinance the home or sell it to someone else. See Chapter 7 for more information about the memorandum. Finally, focus on and pursue primarily the sellers with equity. If the seller has a lot of equity in their home, then even if something bad did happen to them, they would have some cushion to fall on.

Let’s look at three scenarios.

1. The seller has $50,000 of equity and has a $30,000 lien placed on their home by the IRS. No problem—the sale will close fine. The IRS will take $30,000 and the seller will get the remaining $20,000 of equity.

2. The seller has $50,000 of equity and the IRS has a $70,000 lien placed on the home. Again, the sale will close fine. The IRS will take the entire $50,000 and the seller will still owe the IRS $20,000. The IRS does not want to stop a closing but it will take what it is owed. You will probably have to coordinate with a title company or attorney, whoever does the closings in your state, to coordinate the payoff on the lien.

3. The seller has $30,000 of equity and has $45,000 of liens placed on them by five different individuals or companies. This one may be a problem if those five companies will not cooperate by taking
a smaller amount to close out this home. In other words, most lien holders will take something now to get a partial payoff rather than nothing at all. If they are owed $10,000 on a lien, they might take $7,000 now and would still be owed $3,000. In this case, the deal will probably still close, but it will take more work on the seller's part or, more likely, on your part to get these lien holders to cooperate. (Because of emotional tensions between the seller and the lien holders, the seller may not be the best one to negotiate with them to take a little less to make the deal close.) You might even be able to get them to take less as a full payoff—in other words, take $7,000 as full payoff for the $10,000. Either way, I have never heard of a deal where it could not work out. However, this is the risk for a lease option.

The worst thing I have ever had happen on a lease option deal was delinquent property taxes, which I knew about. There was plenty of money to pay for those at closing, and the sellers were not far enough behind to go into foreclosure over the taxes. Had they been in danger of going into foreclosure for back property taxes, I would have paid them myself or the seller would have paid them.

**Wendy’s Advice on Lease Options**

Only buy from financially strong sellers. They are less likely to have any financial problems down the road. Sellers with equity are the best choice because if financial problems do arise they have some cushion to cover the problems.

**Matching Motivated Sellers with Lease Options**

As discussed previously, subject-to sellers are usually, but not always, motivated by bad debt and a desperation to restore their credit. Conversely, lease option sellers have good credit, and the sellers that would even consider a lease option fall into two categories:
Lease Options versus Subject-Tos

1. Sellers who don’t need their cash out of the home to move on.
2. Sellers who have no equity in their home—they are financed 100 percent.

I prefer a seller in the first category. Why? This seller has some cushion financially if problems arise later. The second category of seller does not have a cushion, and therefore if they get into financial trouble, they are more likely to botch up the deal—either permanently or for a period of time until things can be resolved.

Here are five types of motivated sellers with good debt.

1. Long-time home owners. They usually have very low payments, if any, and usually have saved money elsewhere, which enables them to purchase another home without selling the current one. These types of sellers also have the cushion of their home equity, which will mitigate any bad luck on their part. When a seller has a low payment, it creates a good opportunity for the investor to get a lower payment also. This will be good for creating strong cash flow.

2. Inherited property owners. Sellers who have inherited properties also have a potential of a lease option sale. If there are many heirs, say five or six, for instance, it is less likely to work out as an investment or rental property because in large families there is always one heir who is broke and needs the cash out. Also, when they divide the rent by five or six, the split of the money on the rental seems too inconsequential to bother with. This is why on inherited properties, I have found that cashing out the sellers (i.e., outright purchasing) is the best way with a large number of heirs, whereas lease optioning is a possibility with a small number of heirs. I have one lease option property now that the seller (one heir) has asked me several times not to pay off. We are now in year five. My price to her has not changed. She likes the cash flow each month and doesn't have to worry about maintenance or bounced checks when working with me. If the tenant-buyer in the home buys soon, then she will be cashed out. If not, she will probably continue to extend as long as I need it.

3. New home builders. The sellers have built or bought their new home and their old one hasn't sold yet. These sellers can afford both homes—they qualified for both—but why would they want to pay for two homes when one is vacant? As time goes on and the old home still has not sold, the seller's motivation becomes higher. This does not
mean the seller must sell, but that they really want to sell or get rid of that old payment. They did not need their cash to buy the new home, and therefore are a good candidate for an option.

4. Newly married. The seller has recently gotten married or moved in with someone who owns a home. This seller would not need their cash out to buy a new home, because they are living with someone who has a home. Since this seller could afford to pay the home payment before they moved in with their partner, they can certainly afford it after they moved in with someone. They just don't want to pay for a home that is sitting vacant.

5. Job transfer. The seller has been transferred out of state. This type of seller will not necessarily need their cash out of their home (equity) because they may not be sure how long they will be in the new location, whether the job will work out, or even where they would want to live.

Subject-To and Lease Option Pros and Cons: An Overview

Let’s examine the comparative pros and cons of subject-tos versus lease options.

**Subject-To Pros**

- Title is in your name—full ownership.
- Some sellers will pay you to take the deed.
- Easier to prove “seasoning of title” when you are the title holder; easier to refinance.

**Subject-To Cons**

- You own it and have ethical responsibility to the seller even if the market changes or you can’t sell the home. No changing your mind on this one.
- Possible due on sale clause being called—therefore you might have to refinance or sell the property.
- In some states, mortgage brokers and Realtors could be fined and/or subject to revocation of their license. It could be considered against
Lease Options versus Subject-Tos

Subject-To Pros (Continued)

If you are on the title you will have long-term gains versus short-term, if you hold the home for longer than 12 months.

Subject-To Cons (Continued)

their code of ethics to assist a person in violating a clause in a contract.

Sellers with lots of equity will be hesitant or completely against relinquishing the deed.

Lease Option Pros

You don’t have to buy later if the market drops or there is something wrong with the home. You can get out.

Lease Option Cons

Title is not in your name so you are vulnerable to seller error. You must be careful to screen the seller. Only option from strong sellers, not those in trouble or headed for trouble (unless you put the deed in a land trust).

More sellers will do an option rather than give up a deed—especially on nicer homes.

You will have short-term capital gains versus long-term if you are not on the title. This can be avoided if you finance it with 12 months of payments (see the pros column), get on the title, and hold it for 12 months before closing with your tenant-buyer. This solution takes a minimum of 24 months.

After 12 months of payments, many lenders will treat a lease option as a refinance—as if you were on the deed. It would be treated like a land contract refinance.

Some sellers might feel an option is not closure on their home. Some will feel better with a deed being transferred or a lease purchase (which is a guarantee vs. an option).

(Continued)
A way to get nicer homes—more likely the seller is not behind and has taken better care of their home. This type of seller is also more likely to consider a lease option versus signing over the deed.

Seasoning of title starts when you file a memorandum of option or lien of interest. Most lenders consider this adequate and similar to recording a deed (with the exception of FHA).

Sellers with lots of equity are more likely to give you the right to buy the home than they are to give you the deed to their home.

Sellers with lots of equity usually want to close and get their equity out.

**Putting the Techniques into Practice**

Now let’s see how you would apply these techniques in different situations.

**An Example Where You Must Get the Deed**

A seller calls you on the phone and says he is two months behind on payments. Do not option this home! This seller is in trouble financially and is not a good risk for an option. Anyone in a bad financial situation is not a good seller for an option. This is the type of seller that you must get off of the deed so that his financial situation will not affect the title to the property in the future.

Not every seller who is in financial trouble will tell you so, which is why you always need to do research on the title before you get the
deed or do an option. In this case, you will need to bring the seller's mortgage current. Before you do, you want to make sure that he is the owner of the property and that there are no other liens on the property unknown to you.

An Example Where You Get the Deed

A seller calls you who owes $135,000 on his home, which is worth $135,000. Since he has no equity at all, this type of seller might be willing to give you the deed. And if there is high appreciation or a very low payment, you might be able to make a profit even though there's no equity.

On the other hand, if the seller's payment is too high or the market is slow, you might need to have the seller pay you to take the deed. Yes, there are sellers who will pay you to take the deed to their home. Think about it: If this seller sells conventionally—that is, through a Realtor—he would have to pay up to $10,000 in commission to sell his home. Plus, he'll have closing costs, transfer taxes, and will probably pay points or fees on behalf of his buyer. If he's willing to pay all this money to an agent to sell the property—and wait 90 to 120 days to sell, too—why shouldn't he just pay you to take over his payments now?

If the seller doesn't have the cash to give you, an option would be your best strategy. This way, the seller can pay you the $10,000 over time, or you could arrange for the seller to pay part of the monthly payment during the option period. This way, if he stops paying his portion of the payments, you have the choice of surrendering your option and simply giving the property back to him. When you have the deed, you can't do this.

An Example Where You Should Lease Option or Lease Purchase

A doctor has a new home built for himself. His old home is worth $200,000 and he owes $125,000. He has $75,000 of equity. He is not behind on payments, and he did not need the $75,000 cash out to buy the new home. His old home is sitting vacant and the Realtor has not sold it yet. He qualified for both house payments at the bank and he can technically afford both, but who wants to make an extra house payment?
Although he is motivated to sell because he's paying out of pocket every month to own a vacant property, this type of seller is not going to simply give you the deed and let you take over the mortgage. No way is he going to give up all of his $75,000 in equity, and no way are you going to pay that much cash out of pocket.

When you lease option this house, he gets most of his equity back—although it won’t happen until you sell the property. The deal might work like this: You option the property for $195,000, and make payments to the seller that equal his total mortgage payments. You sell the property on an 18-month lease option for $228,000 with payments to match. You get cash flow plus $33,000 in profit when your tenant-buyer buys the property; the seller gets his payments taken care of for a few years, then gets the bulk of his equity out. And in the meantime, he doesn’t have to worry about management, vandals, frozen pipes, and all the other things that owners of vacant houses have to deal with.

An Example Where You Could Lease Option or Lease Purchase

The seller just inherited a property worth $120,000 from his parents’ estate. It is owned free and clear and he doesn’t need the cash from a sale but would love some cash flow on this asset. This seller is not going to give you the deed. Let’s say you can lease option this property for $700 per month with $300 per month going to the purchase—or the option credit. Your real payment in this case is only $400. You also could do seller financing on this property (like a land contract or mortgage by the seller).

Conclusion

Subject-tos and lease options are great techniques to help sellers in situations that might not otherwise have solutions. If you do your research on the seller and the market, and apply the right technique to the right situation, you will make a profit for yourself and at the same time help a seller who really needs you. Make it a win-win.
Winner: Stupidest Moves Award

My investors group gives an award called the “Stupidest Moves Award” for the person who makes the most ridiculous real estate move during the year. I didn’t even know this award existed until I got it, and the only reason I got it was because I was chatting away about my deals to other investors. I received a mechanical shark, mounted on a plaque, that was devouring a large Monopoly® denomination, to depict the eating away of huge profits.

It was the early 1990s and one of my earliest deals with a Realtor. I was presented with a great deal for a $300,000 lakefront home. I felt I could rent it easily because of its price range and because it was lakefront property. Therefore, I quickly committed to start my option on October 1, whether or not I had secured a tenant-buyer. My rent commitment was $1,400 per month, and of course I planned to charge more in order to make cash flow. October turned into November, November into December, December into January, and January into February. Unfortunately, in Michigan, lakefront properties are not very desirable in the middle of winter. I finally rented it in March. In total I lost more than $7,000 plus utilities for
the winter. I was paying more for a house I wasn’t living in than for my own mortgage.

I could have avoided winning this award by either (1) making my contract contingent on securing a tenant, or (2) waiting until spring to start the lease option. Lakefronts rent the best in the spring and summer in my area. People aren’t crazy about moving into a property with a frozen piece of water in their backyard—water that may not thaw for months. I was too eager and didn’t think it all the way through. Not only did I lose over $7,000 in profit, it was $7,000 in cash out of my pocket. Although I eventually made well over $25,000, it could have been $32,000 with much less stress. That’s how I earned the “Stupidest Moves Award” in my investment group. It’s not the kind of award you want to get more than once, but everyone has a story like that in their investment portfolio. It’s just part of the learning process.

Eagerness to start a deal should never outweigh the need for thoughtful preparation in evaluation and construction of an offer. There are many sellers willing to sell on lease option and subject-to techniques, but they must be profitable for you!

**Wendy’s Tip**

Know your climate. People don’t like to move in the winter in a colder climate, so if you live in a place with bone-chilling winters, structure your deals, if possible, to start and end in the spring or summer. Also, try to work around holiday months, especially mid-November and December everywhere in the country.

**Creating the Offer**

Now that you’ve considered which technique to use, a lease option or subject-to, you need to step back and take the time to work out the profitability of the deal. Normally you should not throw out numbers to the seller in the excitement of the moment. Even if you feel pres-
sured, tell them you need to go back to your office and crunch the numbers. In the excitement of the moment you may voice a dollar figure that doesn't include all the things you need to consider. In the quiet of your office you will have the time to go through your own profitability worksheet, discussed later in this chapter, and make sure the numbers work for you. Negotiations and offers are an art form—take the time to do them well.

There may, however, be situations where you'll need to respond immediately, such as in the case of a subject-to offer on a pre-foreclosure or other competitive bidding situation. Lease option offers, by their nature, rarely require an on-the-spot response. Therefore, you can respond according to the dictates of each specific situation.

Calculating Your Profit Requirement

As an investor, you must determine your profit requirement for any given deal. It may vary depending on the type of investment. For instance, I will accept less for a rehab than a lease option, because I can be in and out of a rehab within a few months, while lease option transactions typically require 12 to 18 months or more. Do you require $10,000 profit, $50,000, or what? Once you determine your profit requirement, that becomes the bottom-line number that must be reachable in order to take on a transaction. For example, if your required profit is $20,000 and an opportunity comes along that will earn you only $18,000, then you'll need to either negotiate the terms of the deal to meet your $20,000 requirement or pass up the deal. Otherwise it will not be a win-win situation for the seller and yourself. Alternatively, you might be able to wholesale the deal to someone else who has a bottom line that is lower than yours, but learn to walk away from deals that don't work for you.

There are times when a seller will do only X, Y, and Z in terms of price, payment, and length of time. You can input those numbers into the spreadsheet in this chapter to determine if the deal meets your profit requirement. Sometimes, if it doesn’t, you can negotiate a little further, as discussed in Chapter 6. Often the seller is not firmly
set on X, Y, and Z, just X and Y; therefore you can negotiate the Z.
Chapter 6 will help you think of creative ways to help bring deals to-
gether. However, there will be some deals where you will need to just
walk away. Some sellers are simply not willing to do what you need
to make it a win-win; some are not motivated enough or can’t go
down far enough on price because they owe too much. Wasted time
is money to you, so learn to move on quickly and look for another
motivated seller.

**Profitability for Lease Options**

The first thing we'll do is create a worksheet for profitability for
a lease option. We will cover subject-to transactions later in this
chapter.

Appreciation can't be predicted exactly, so you will need to esti-
mate it. Newspapers are a great source for the appreciation rates in
your area. Base your estimates on the predictions of your local writ-
ers or Realtor boards. When calculating your option premium, use 5
percent in areas that are very consistent—condos, or in neighbo-
riches where all the homes are almost identical in size or model. If the
neighborhood is very diverse, then you may use up to 10 percent, as
the comparables should be there for the appraiser when you go to sell
the home.

You also need to determine Cash flow or rental values. You can
do rental comparables just like you do sales comparables. Here are
three ways to find the rental comparables:

1. Read the local paper. Check all the local rentals. Those are
   your “comps,” or comparables.
2. Check with people in your local landlords group. Many
   rentals are not on the MLS.
3. Not enough data from the first two sources? Run a test ad in
   the newspaper. Too many calls? Your price might be too low.
   Too few? Your price might be too high. It's a little like fish-
ing—change the bait and see what happens.
Evaluating the Profitability of the Deal

Now let’s use this worksheet to calculate profitability on three example deals.

<table>
<thead>
<tr>
<th>Profitability Worksheet</th>
<th>Lease Option</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase price</td>
<td></td>
</tr>
<tr>
<td>Total purchase costs</td>
<td></td>
</tr>
<tr>
<td><strong>Income Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Current value</td>
<td></td>
</tr>
<tr>
<td>Value of lease option premium (5–10%)</td>
<td></td>
</tr>
<tr>
<td>Expected appreciation</td>
<td></td>
</tr>
<tr>
<td>Expected sale price</td>
<td></td>
</tr>
<tr>
<td>Expected monthly cash flow</td>
<td></td>
</tr>
<tr>
<td>Total other income</td>
<td></td>
</tr>
<tr>
<td><strong>Expected Profit</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Example 1**

Seller will sell you their home for $185,000. It is currently worth $190,000. The appreciation rate is 5 percent per year. It will be sold on an 18-month option, which will result in 7.5 percent appreciation (5 percent × 1.5 = 7.5 percent). That gives us $14,250 ($190,000 × 7.5 percent) of appreciation value during the 18 months. You’ll pay the owner $1,300 in rent. You can rent it out for $1,600, for a cash flow of $300 per month. I usually rent a home for $1,595 versus $1,600 ($1,595 sounds like less than $1,600 and is therefore more appealing to potential tenant-buyers), but it is easier to show even numbers for each of the examples.

The homes in this neighborhood are diverse and unique. Prices range from $170,000 to $285,000. This allows us to build in a higher option premium of 10 percent, or $19,000. The $19,000 option premium and the $14,250 appreciation adds $33,250 to the retail value of
the home. What is your estimated profit in 18 months? Let’s view how I would figure out the profit of this deal:

The resulting profit from this deal, if all payments were made during this option period and it went the full 18 months, would be approximately $43,650, less transfer fees, title insurance, and possible option credits from the investor (you) to the buyer. Does this meet your required profit? If so, then move forward with these terms. If not, you continue negotiations on the deal or pass it up.

**Example 2**

Seller will sell you their home for $145,000 on a 12-month option. It is worth $145,000. The appreciation rate is 3 percent per year, which will result in an additional $4,350 ($145,000 × 3 percent) after one year. This home is in an area where all the homes are similar and range in price from $140,000 to $152,000. This results in a more modest option premium of only 5 percent, or $7,250 ($145,000 × 5 percent). The appreciation and the option premium total $11,600 ($4,350 + $7,250). You’ll pay the owner $1,000 in rent and will in turn rent it out for $1,200. The seller is also willing to give you $200 a month

![Profitability Worksheet](image-url)
credit toward buying this home. Let’s look at your estimated 12-month profit:

**Evaluating the Profitability of the Deal**

This deal would not be nearly as profitable for an investor. It would only generate $16,400 before closing costs, not leaving much room for potential problems. This opportunity does not meet my minimum profit requirement. However, there are ways to renegotiate the deal with the seller. With the appreciation this low, it must be more of a buyer's market. You should be able to negotiate price and terms. Ask for a better price and for additional monthly credit towards the purchase. You can also ask for the equity buy-down of the mortgage during the option period. For example, if the seller owes $100,000 on the home at the start of this option and at the end they only owe $90,000, then you would receive the $10,000 of credit that was paid on the mortgage balance during the option period, because in effect you had been paying that mortgage payment during the option period.

If the seller does not agree to the additional terms, let it sit until their motivation increases enough for them to agree to terms that would make this transaction meet your profit requirement. It must meet your bottom-line number and result in a win for both you and the seller.

### Profitability Worksheet

**Lease Option**

<table>
<thead>
<tr>
<th></th>
<th>Example 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase price</td>
<td>$(145,000)</td>
</tr>
<tr>
<td>Total purchase costs</td>
<td>$(145,000)</td>
</tr>
<tr>
<td><strong>Income Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Current value (same as purchase price)</td>
<td>$ 145,000</td>
</tr>
<tr>
<td>Value of lease option premium (5%)</td>
<td>$ 7,250</td>
</tr>
<tr>
<td>Expected appreciation (3% annually)</td>
<td>$ 4,350</td>
</tr>
<tr>
<td>Expected sale price</td>
<td>$ 156,600 $ 156,600</td>
</tr>
<tr>
<td>Expected monthly cash flow ($200 per month for 12 months)</td>
<td>$ 2,400</td>
</tr>
<tr>
<td>Option credit from seller ($200 per month for 12 months)</td>
<td>$ 2,400</td>
</tr>
<tr>
<td>Total other income</td>
<td>$ 4,800 $ 4,800</td>
</tr>
<tr>
<td><strong>Expected Profit</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 16,400</td>
</tr>
</tbody>
</table>
Example 3

Seller has a home worth $235,000 and they will sell it to you for $225,000 on an 18-month option. The appreciation rate is 5 percent per year (or 7.5 percent over 18 months), which would generate an additional $17,625. This home is in a very diverse area out in the country. The homes vary widely in square footage and acreage, and prices range from $150,000 to $450,000. These factors let us establish the option premium at 10 percent, or $23,500. The rent you pay the owner is $1,200, and the market rent you expect to receive is $1,450. The seller owes $150,000 on the mortgage and agrees to take $75,000, less closing costs, at the time of closing ($225,000 sales price less $150,000 current mortgage balance). This allows you to get the mortgage equity during the option period. The equity from the principal pay-down during this option period is estimated at about $200 per month or $3,600. What is your estimated profit in 18 months?

**Profitability Worksheet**

<table>
<thead>
<tr>
<th>Lease Option</th>
<th>Example 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase price</td>
<td></td>
</tr>
<tr>
<td>Total purchase costs</td>
<td></td>
</tr>
<tr>
<td><strong>Income Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Current value ($10,000 above purchase price)</td>
<td></td>
</tr>
<tr>
<td>Value of lease option premium (10%)</td>
<td></td>
</tr>
<tr>
<td>Expected appreciation (5% annually, 7.5% over 18 months)</td>
<td></td>
</tr>
<tr>
<td>Expected sale price</td>
<td></td>
</tr>
<tr>
<td>Expected monthly cash flow ($250 per month for 18 months)</td>
<td></td>
</tr>
<tr>
<td>Expected monthly equity ($200 per month for 18 months)</td>
<td></td>
</tr>
<tr>
<td>Total other income</td>
<td></td>
</tr>
<tr>
<td><strong>Expected Profit</strong></td>
<td></td>
</tr>
</tbody>
</table>

Note that no commissions are paid to Realtors in these examples. Working with Realtors is discussed in Chapters 10 and 11. However, if you are paying any Realtor commission or option fee up front to your seller, you will have some out-of-pocket costs. This will
not affect your bottom-line profitability, as option fees are applied to the purchase price at closing, but it will affect your up-front cash out-of-pocket expenses.

Which of the three scenarios will get you to financial freedom? The answer is that they all can, if you do them correctly. The second one would probably require changes from the seller to make it work for you.

The primary profit source is the back end—the difference between the purchase price and your selling price, which is realized at closing at the end of the lease option period. When you’re first starting out, you might deal with smaller back ends. That’s fine—those deals help you learn the business. As you become more skilled in working with options you will find more ways of improving the numbers to get you higher returns that are still a win-win. Obviously, the higher the back end, the easier it will be to begin working your way towards your financial goals.

Wendy’s Tip

There are always unexpected costs in any deal and, so, I like to make sure that I have extra profit built into any real estate transaction. Always plan for something that could go wrong—someone who won’t pay rent, a furnace that goes out, a roof that leaks, a septic field that fails, and so on. Plan for the worst and you will be safe.

Profitability for Subject-Tos

Subject-to transactions are similar to lease options except you will be taking over a loan balance and possibly other liens or back taxes. Once you complete a subject-to negotiation, you will be done with the seller. You’ll have the deed to the property and you won’t close with the seller again the way you do with a lease option. The worksheets seem more complex and there are more numbers to fill in, but they are essentially not much different than lease options.

As with a lease option deal, you will need to determine whether
a subject-to deal is profitable enough to consider. You must run the numbers. Here is an example of a profitability spreadsheet for a subject-to deal.

In addition to the elements of the base option worksheet, this worksheet asks for information about the balances on the loans, other liens, principal of the mortgage during the option period, and escrow balance. The principal on the loan is negotiable on a lease option deal, but it is a given on a subject-to deal because you are now the owner. You will get the principal for as long as it is optioned to a buyer. The exit strategy (selling it on a lease option) will be figured out the same way for a subject-to as in the previous lease option examples.

Any back payments due on a mortgage are also part of the current balance due reflected on a mortgage. In other words, if the lender shows that the balance is $145,500 and the amount currently due is $3,200, then the balance will be reduced after the $3,200 pay-
Evaluating the Profitability of the Deal

ment is made. Make sure you show that in your calculations and adjustments. The escrow balance is the amount in the escrow account at the time of the subject-to assumption. The escrow account contains funds set aside to pay the taxes and insurance that will be due in the future. If you complete the applicable paperwork, you can make sure that any outstanding escrow funds go to you, rather than to the previous owner.

Note: Escrow numbers vary monthly. The numbers in these examples are simplified. Also, the cash flow and principal payments have been rounded to even numbers to make the spreadsheet figuring easy to calculate. This is also how I do it in my deals. Tracking numbers down to the penny unnecessarily complicates your analysis.

Example 1

The seller owes $140,000 on their first mortgage and $23,500 on their second. They are behind $3,300 between the two mortgages. Their property taxes and insurance are current and they have no other liens on the home. The home is currently worth $175,000, and it is in a market that is appreciating at 6 percent a year. The neighborhood is diverse and has many comparables. It is comprised of homes ranging from $150,000 to $250,000. We will set the option premium at 10 percent to sell this home to our tenant-buyer.

The payments between the first and the second mortgage are rather steep: $1,050 for the first, which includes taxes and insurance, and $150 for the second mortgage, for a total of $1,200. This home will only rent for $1,100 a month, so you have a negative cash flow situation. It is not uncommon to have negative cash flow on a subject-to for two reasons: (1) Many sellers have two mortgages, which results in higher payments; and (2) many sellers have higher interest rates due to poor credit, which also results in higher payments.

The principal portions of both mortgage payments during the option period are approximately $250/month, or $3,000 for the 12 months ($250 \times 12). The escrow balance received from the seller when the home was purchased was approximately $1,750.
Would you do a subject-to deal for $39,750? If so, this is a good deal for you. The numbers do not include the transfer fees, title insurance, and any option credits given to the buyer at closing. You need to keep in mind the up-front funds required to do this deal. It requires $3,300 cash when you take the deed and a negative monthly cash flow of $100.

**Example 2**

The seller owes $322,000 on the first mortgage and does not have a second mortgage. They are current on their mortgage payments of $1,900 per month PITI. They have no other liens owed on the home. This seller is not in financial trouble but is willing to give you the deed on the home, which is worth approximately $340,000. The neighborhood is fairly consistent with comparables, so only a 5 percent option premium is available on the resale side. Most of the homes range from $340,000 to $350,000 and are similar in size and square footage.

The real estate market in this area is appreciating slowly at 2 percent and the rental rate is $2,000 per month. You can sell it on an
18-month lease option. There is a $2,200 escrow balance available and the mortgage payments have approximately $200 per month going toward principal.

Why is the profit on this deal better than the prior scenario, when the appreciation rate and option premium are lower here? This one comes out better because of the higher value of the home. The appreciation and option premiums are based on a larger value. This one would be more risky if you couldn't rent it for $2,000 a month, in which case you might want to rent it for less and take the negative cash flow for a few months until you can refinance it with a better rate loan. If the mortgage rates are low enough, you might be able to get a lower payment and make this home generate a positive cash flow.

Example 3

The seller owes $110,000 on a first mortgage and $22,000 on a second mortgage. The payments are $870 for the first mortgage and $150 for the second. The taxes and insurance are an additional $210 per
month. The total of all payments is $1,230 (principal and interest for both mortgages, along with taxes and insurance).

The seller is behind two years in taxes for $4,200 (including penalties) and three months of payments on the first mortgage for $2,610. The home is valued at approximately $135,000. Homes in the area are very similar and the option premium would be only 5 percent. The appreciation in the area has been fairly steady at approximately 4 percent per year. You can do a 12-month lease option and rent this home at the market rate of approximately $900 per month. This would put you in a negative cash flow situation. The payments on the mortgages are going toward principal at approximately $300 per month, and there is no escrow balance on this loan.

<table>
<thead>
<tr>
<th>Profitability Worksheet</th>
<th>Example 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Balance owed on first mortgage</td>
<td>$(110,000)</td>
</tr>
<tr>
<td>Balance owed on second mortgage</td>
<td>$(22,000)</td>
</tr>
<tr>
<td>Back payments and liens</td>
<td></td>
</tr>
<tr>
<td>Back payments $2,610</td>
<td></td>
</tr>
<tr>
<td>Taxes owed $4,200 (Up-front cash requirement)</td>
<td>$(132,000)</td>
</tr>
<tr>
<td>Total debt owed on property</td>
<td>$(132,000)</td>
</tr>
<tr>
<td><strong>Income Sources</strong></td>
<td></td>
</tr>
<tr>
<td>Current value ($10,000 above purchase price)</td>
<td>$135,000</td>
</tr>
<tr>
<td>Value of lease option premium (5%)</td>
<td>$6,750</td>
</tr>
<tr>
<td>Expected appreciation (4% annually)</td>
<td>$5,400</td>
</tr>
<tr>
<td>Expected sale price</td>
<td>$147,150</td>
</tr>
<tr>
<td>Expected monthly cash flow (~$330 per month for 12 months)</td>
<td>$(3,960)</td>
</tr>
<tr>
<td>Additional principal from mortgage</td>
<td>$3,600</td>
</tr>
<tr>
<td>Payments during option period</td>
<td></td>
</tr>
<tr>
<td>Escrow balance</td>
<td>$—</td>
</tr>
<tr>
<td>Other income</td>
<td>$(360)</td>
</tr>
<tr>
<td><strong>Expected Profit</strong></td>
<td>$14,790</td>
</tr>
</tbody>
</table>

This deal does not look good at all. You will only make $14,790, less transfer fees, title insurance, and any option credits you give your buyer. This also assumes nothing else goes wrong with the deal. Along with the low profit margin, you would need to pay $6,810 out of your pocket and endure 12 months of negative cash flow.
Evaluating the Profitability of the Deal

What can you do? You must negotiate more with the seller. Chapter 6 discusses in more detail how to negotiate with the seller, but in this example one thing you can do is ask the seller to pay the $6,810 that is behind, or make payments on it to you. You can also ask the seller to continue to make payments on their second mortgage while you make payments on the first mortgage only. Some sellers will even pay you to take the deed to their home so they can move on with their lives. Adjust some things around to see if anything can be done with the seller to make this deal work. But you may just need to say, “Next.”
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

Build Rapport and Make a Deal!

In one house I visited for a potential purchase, the woman had a lot of birdcages in her garage, and all of them had price tags. Either she was about to have a garage sale, or she had already had a fairly unsuccessful one. I didn’t know anything about birds, but I suddenly had a crazy thought that I could get a parrot and teach it to say, “Hi, welcome to Majestic Realty” when people came through the office doors. I dropped the idea pretty quickly when she told me that birds pick up almost everything they hear you say—I could just imagine it repeating things my office staff say when they hang up the phone from tenant calls: “That tenant is lying”; “Liar, liar”; “Yeah, Grandma died again!” Nevertheless, I continued to chat with the seller about different types of birds while looking around at the house.

This is an example of how to build rapport with a seller. People like to talk about what is important to them. It makes them feel more comfortable with you. As it turned out that day, one of the cages was marked $20 and I decided to buy it, thinking perhaps one day I’d get a bird. I couldn’t fit the large cage into my car, so I told her that I’d send some of my work crew back that evening to pick it up in their truck.
At this time, we were in a strong seller’s market, and I already had a tenant-buyer who wanted to buy this home, and I was going to try to purchase this home outright. Our market was very hot!

I made an offer through the Realtor the very first day. She called me that evening and said, “Well, we have another offer.”

I had figured this was possible. That home had just come on the market that morning, but homes don’t stay on the market long in a hot market, especially in that price range.

She continued: “But let me tell you the stupidest thing I’ve ever heard.”

I said, “What?”

The Realtor said, somewhat angrily, “She accepted your offer.”

I asked, “Why is that so stupid?”

“Because the other offer was $5,000 more than yours with the same terms, and that’s just stupid to me, Wendy. But do you know why she accepted yours? She likes you.”

Did the birdcage discussion save me $5,000, or did it get me the house? I think it did both. I didn’t buy the cage to get the house, but everything you can do to make a prospective seller feel comfortable with you will ultimately be worth it. I always tell my students that if they are not comfortable building rapport with sellers, they should send someone else, because it is such a crucial element to succeeding in this business. That seller was not in position to just give away $5,000, yet it was important enough for her to sell her home to someone she felt good about that she took $5,000 off her price. Make it a point to establish rapport and you will almost always get a better deal.

How to Build Rapport with a Seller

If you were trying to sell your house, who would you give a better price to? The buyer who came in saying, “I don’t like your carpet color. Are you going to replace it? The walls won’t match my furniture. This kitchen is just not my style”? or the potential buyer who said, “I like the layout. I see there’s a ding in the wall. You don’t mind if I fix that, do you? I just want to make this my home. I love it.” You would choose the second person, of course, because they are reasonable and are trying to work with you. You would instinctively want to work with them.
Building rapport with the seller is key to making a deal. If the seller doesn’t like you, the deal will probably never happen. Therefore, if meeting people and being reasonably conversational and interested in the seller’s home isn’t your strength, take someone with you who is warm and friendly and can bridge that gap for you. The reason this is so important is because, for either lease option or subject-to transactions, you’re asking someone to give you control of their house with little or no money down. They must feel comfortable with you.

In a rehab situation, while it’s still important to establish rapport, it’s also appropriate to point out problems in the property. You want the seller to be prepared for your lower offer when it comes. Buying at a low price is more critical to your profitability when doing a rehab and sale than when taking control of a property and holding on via a lease option or subject-to approach. But in a lease option or subject-to, emphasize the positive—you will want the seller on your side.

I start out with rapport building questions. As I enter the house, I quickly look around for items connected to children or pets, or something of significance, like a hobby or a collection—anything that I can use to talk about something of interest, other than the house. Then I ask about those items. I’m seeking to get everyone to lighten up, and talking about something significant in their life will do that.

Then I ask, “What is it that you’re trying to accomplish with the house (not “your home”—I want to separate out the emotional ele-
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

I want them to see that I honestly care about them and their situation (and I do—if the deal isn’t right for them, I won’t do it). This will pay off huge returns when we start talking about the terms of the deal. They don’t care that I’ve been in real estate for over 20 years and they don’t care that I’ve done over a thousand deals. They don’t care that I taught the loss mitigation department for the third largest diversified lender in America how to work with investors. What they care about is whether I can help them with the problem that’s in front of them.

Some sellers like to feel like they’re dealing with an individual rather than a company, while others like to be reassured that there is a company behind the person. Each seller is different, and you need to learn how to read them and accommodate them. The more personal you can be with a seller, the better they will feel about making the deal. Of course, when the paperwork comes through, it will have my company name, but when I’m talking with the seller it’s just between them and me.

Books have been written on negotiations with sellers. Read them to get more details on the psychology of negotiating. Some of them have really helped me understand people and why negotiating itself is so important to completing a deal. This chapter offers ideas specifically on building rapport with sellers, presenting informal proposals to them, negotiating terms, and handling their questions and objections for lease options and subject-tos.

Putting Together the Proposal/Offer to the Seller

I tell my students to follow three basic steps in writing a proposal or offer to the seller:

1. Keep it simple.
2. Do your homework.
3. Determine your offer.
Keep It Simple

Sometimes we get too formal. We want to make sure we have the proper letterhead and business cards and look official up front. We feel this gives us the legitimacy a seller expects. However, counterintuitively, there are times when too much polish may in fact be detrimental to us because the seller finds it impersonal. Save the formal documents for after the deal is negotiated, when it needs to be drawn up in detail (see Chapters 7 and 8). For preliminary proposals it’s best to outline several scenarios, even handwritten. (Refer to the proposal in Chapter 11 used with Realtors. You can use the same format with a seller—less any commission or Realtor information.) Many deals are made on bar napkins, and they are legitimate and legal as long as they are signed. It’s all about personal relationships, not just professionalism. The seller needs to like you, not your business card.

Putting out an offer is a lot like fishing. We’re trying to find out what’s important to the seller, where they are financially, whether they need their cash out, and what terms will work for them. If the seller is not sure, use the proposal format in Chapter 11 and give them a few scenarios in writing to help them evaluate different alternatives. Many times they will know what areas are most important to them. For instance, price might be the most important area to a seller. You then can work around price by negotiating the other areas of terms to make the deal work for you. You will have to tweak the other areas of the lease option or subject-to in order to get your profit requirements, but at least you know where the seller is starting—where they are firm and what is important to them. Then use the profitability worksheets in Chapter 5 and make sure the numbers will work for you.

When you agree on the terms with the seller, then you should formalize the contracts. When I think there is going to be a meeting of the minds, or if the Realtor says they want everything in writing, or if the seller says “I want to see every piece of the contract before I agree,” then I put everything together. I try to make my offer in the way the individual seller prefers it. Some like to just discuss it and others want it in writing. Occasionally, timing is critical and negotiations must be done quickly, and contracts are also drawn immediately.
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

Do Your Homework

You can't put together a proposal without first doing some research, especially if you are in an area of town that is new to you. You can't base your offer purely on what you think the home is worth; you must incorporate the comparables as well. Find out what similar homes in the area are worth, either by checking the newspaper or using the MLS. The MLS is protected by Realtors in most areas of the country; however, it is available to the public in some parts of the country. Ask investors in your local real estate investor club the status of the MLS in your area. If you have a relationship with a Realtor, you can ask them what the comparables (comparable market values) are in a certain neighborhood.

Understanding the current economy is essential to making offers on lease options and subject-tos work, and work effectively. For instance, are you in a strong buyer's or seller's market? Understanding the differences and how they affect the sellers is key to successful negotiations. The techniques I teach will work in either a buyer's or seller's market; however, it is important to know which market you are in so you can establish your offer correctly. (See Chapter 3 for more about buyer's and seller's markets.)

Strong Seller's Market

In a seller’s market you’re going to buy higher. When things are appreciating in a seller’s market, I have no problem paying closer to retail for a property. There are times when you could even pay higher than retail and still be profitable based on favorable appreciation and other terms. You must work the numbers yourself. Your value in the property is going to come from not only the appreciation but also from the lease option when you sell.

Strong Buyer's Market

The opposite is true in a buyer’s market. The economy will be slow, probably with higher unemployment rates. Real estate listings aren’t moving, in which case you need to buy low—meaning below the retail value—because you can’t count on appreciation. When the market is slow, the buyers have less money and are less able to take on more debt. The advantage of the buyer’s market is that you can cherry-pick your deals.
Remember this in negotiating with your sellers. If your sellers are unwilling to give, you have to move on, because they are not the motivated sellers that we discussed in Chapter 3. The slower the market, the more you can negotiate. As more properties are languishing on the market, there is a large pool of motivated sellers for you to choose from. You can be selective in order to find deals that work out for you and the seller.

How to Determine Your Offer

The following are potential areas of negotiation for a subject-to:

- Price.
- Seller paying part of payment.
- Seller paying to take over payments.
- Length of term.
- The point at which the agreement locks in.

With lease options, there are too many variations to discuss in detail, so I will mention only the key areas available for negotiation. When structuring your lease option with the seller it is important to understand which of these criteria are most important for them:

- Price.
- Length of contract.
- Monthly payments.
- Option credits.
- Mortgage buy-down—the principal adjustment.
- Automatic renewal periods.

In addition to these criteria, I usually include terms that will limit my risk. One approach is to include a clause that says my lease option can be terminated within 60 days with written notice to the owner. This provides an agreeable exit to problematic transactions.

Another method that I use even more frequently is to make the
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

start of the lease option contract subject to finding a tenant-buyer. This significantly reduces your overall risk and avoids having to begin funding monthly payments before you have your own funding source in place.

Multiple Offers

Sometimes you will need to create multiple offers on the same property. This is usually for a lease option, but it may also apply to some subject-to offers. For example, let’s say I make an offer of three years at $225,000 and pay the seller $1,000 per month. The seller then looks at appreciation rates and says they don’t want to lose out on all the appreciation that I will profit from in the next three years. So I then structure a second offer where I might offer to go five years and give them a little more on the sales price as well as a little more each month, but they have to agree to all five years. You might also want to do a step approach based on appreciation with a lower percentage than the market appreciation, so that you aren’t giving away the entire profit. For example, one time I purchased a home from a seller who wanted part of the appreciation, which at that time was 10 percent per year. I asked him how much he was expecting. He responded with 2 percent per year, which I felt was fair, and we settled on him receiving part of the appreciation and me receiving most of it. You can give away part of the profit and still make it a win-win.

When objections arise, put yourself in the seller’s shoes and reflect on what they say. Always try to come up with creative solutions to keep the discussion going. Find out what their concern is, and if you can fix it, say, “If I could do that for you, would you do the deal this way?” Find the seller’s key issues so that you know what terms are more flexible for them. Whenever you give up something, negotiate something back in return. With a seller, usually the first question they ask tells you the most important issue to them. If they mention two or three different issues, find out which is the most important.

Find the Seller’s Sticking Point

Sellers will have something that means more to them than anything else. Find out what this is so that you can structure a deal that makes them happy while simultaneously meeting your requirements for
profitability. For instance, the price of the home may be more important to some sellers than when they will receive it. Other sellers might want a very specific monthly payment, but their overall price is negotiable. Work with each seller to understand what makes them tick, so that you can tailor an offer to suit them best.

Handling Rejection

When you make your proposals, sometimes the sellers will accept, and other times they will shake their head and walk away. It’s best to soft-pedal their rejection with a comment such as, “Well, things might change for you, so please give me a call somewhere down the line if you’re still interested.” Many do come back to me that way. Sometimes people don’t want to act today because it’s not a win-win for them, but a few months down the road they’re feeling much more motivated. Always handle all sellers graciously and be accessible. You never know when they will call back and say, “Okay, now we want to accept the proposal that you presented to us a while back.”

Overcoming Sellers’ Objections

If you have properly built rapport and trust with the seller first, their objections should be minimal and can be handled confidently and easily. Too many seller objections usually means you have a seller who is not as motivated as you thought; however, they may just have questions that need to be answered. Learn to love objections. Objections are buying signals. The seller is indicating that they need more information before they can make a buying decision—in other words when they have objections, they want more information. I have gotten to the end of my presentation and the homeowner had no objec-
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

tions, and of course I didn’t get the home. Obviously I either missed asking the correct question or I didn’t pick up on the homeowner’s hot button.

Once you have overcome any particular objection, it is part of your repertoire. I can’t wait for that question to come up the next time.

One technique that I like to use is to feed their question back to them. Many times we think we understand the question when the intent was something else. For example, if a seller says, “Your offer isn’t enough!” I reply, “My offer isn’t enough?” and then look at them and don’t say another word. What I’m trying to do is see if the question is a smoke screen or if there is another objection. It could be that my offer isn’t enough money up front; it could be that my offer is for too many years. By feeding it back, I put the ball in their court and get more information, so that I can give them a correct answer and avoid bringing up another objection they hadn’t thought of.

Wendy’s Tidbit

Learn to love objections—they are buying signals!

There are, however, some common objections and questions that you need to be prepared to handle.

Lease Option Questions and Objections

Here are my recommendations on how to handle each of these objections and questions.

I Don’t Want Tenants in My Home.

The number one objection for sellers who are doing FSBOs is that they don’t want tenants in their home. They need to understand that future home buyers are people who want a home to take care of. Let the seller know that you understand their concern: “I want you to know that I really screen my tenants and they are hand-selected by me. I also am not going to put just any tenant into your
home. I am putting a future home buyer in your home. These types of tenants take better care of a home, because they are planning to purchase it.”

**What If You Don’t Make My Mortgage Payment?**

There are at least three ways you can answer this one. Use the one most comfortable, fitting, and true for your situation.

1. “I understand your concern. I have been in this business a long time and can give you references from other sellers like yourself, if that might make you more comfortable.”

2. “I understand your concern. What would make you more comfortable and yet protect us both?”

   If they want to make their own mortgage payment and have you make your payments to them instead of to the bank, you need to protect yourself. They should provide proof to you of their payment, and/or you will want to have bank authorization to check this out yourself. This is a document signed by the seller along with all of the other contracts for the lease option. There should also be a signed agreement that if they don’t pay on time, you would have the right to switch your payments from the seller to the mortgage company.

3. “I understand your concern. I could make your payments to the mortgage company and then mail the receipt to you. This way I am protected and so are you. Would this work for you?”

**Why Won’t You Put More Down in the Option?**

Answer: “If I were to put a lot more down, I wouldn’t be able to buy more homes, and I’d like to help more sellers and invest in more properties than just one. There’s also more risk to me because I do not actually own it, so I don’t want to put too much down.”

**What If You Don’t Buy?**

Reassure the seller that if the option doesn’t get exercised, then the home reverts to the owner in equal or better condition. Also agree to give reasonable notice of 30 days.
Negotiating the Deal: Steps to Buying on Lease Options and Subject-To’s

What Happens If You Die?
Answer: “The contract has provisions that if I die or the seller dies, the contract still binds our heirs to continue on.”

How Long Does It Take for You to Buy the Home?
Be honest. Because tenant-buyers may come and go before one settles in permanently, you need to give yourself time to close the deal, and 20 to 24 months is usually how long it takes for a deal to finalize. We hold the buyer’s hand all the way, walk them through the mortgage process, and do everything we can to make the purchase occur. We are not, however, mortgage brokers and we offer no mortgage advice.

Why Do You Need X Years to Buy This Home?
Answer: I need time to find the right tenant-buyer and get them through the mortgage process. Approximately half of my tenants end up exercising. It’s very important to have enough time to make it work, and with each new tenant it takes at least a year for them to clean up their credit to qualify for a mortgage.”

How Do I Change the Insurance on the Purchase Agreement?
The seller can simply call their insurance agent and they will take care of it for them—it just has to be turned into a non-owner occupied insurance policy. This doesn’t affect the rates much (if any) but it gives the seller the proper coverage. Be willing to do a three-way call with the seller and the seller’s insurance agent to make sure they get the right coverage. They should also put you on as an additional insured, because you have an additional interest in the property. If you made improvements and then sold it to someone at a different price, you have to be covered for the amount of equity that you have built into that property. You should also be an additional insured on your tenant-buyer’s policy so that you’re covered if anything happens to the house before they buy it. As an additional insured, you also get notice if the policy ever lapses. If their insurance does run out, you have the right to go buy insurance and then bill the seller for it.

What Kind of People Are Going to Rent My Home?
“The best kind.” Some sellers want to discriminate regarding the types of tenants that move in, but I have to tell them that by law I
can’t discriminate. If discrimination issues are important to the seller, I tell them I’m not the right person to buy their home. On the other hand, I’m going to take care of their property and put someone qualified into their home.

**What If the Tenants Trash My Home?**

Naturally, this is a major concern to any seller. You can answer, “I can understand why this would be a concern to you, but I want to assure you that I really do screen my tenants carefully. I am putting not just any tenant in your home—I am putting a future home buyer in your home. But if anyone does any damage to your home, then I would take care of it. I am fully responsible for your home.” If they need further assurance you can let them know that their home is also your investment, so you’re looking out for it very carefully.

**Can My Attorney Review the Contracts?**

A simple answer here: “By all means. I recommend it!”

**Can I List My Home with a Realtor Since You’re Not Ready to Commit Yet?**

“Absolutely, go ahead and list it, but please make sure you list my name as an exclusion, because if I do buy it during this time period, you don’t want to pay a commission on me.”

**Can I Come Look at the Property During the Lease Period?**

They can, and it says so in the contract, but they need to go through me to do it. They can’t stop by unexpectedly or drop in on the tenants, because that would violate the tenants’ rights. They need to call me to coordinate their visit.

**Subject-To Questions and Objections**

Potential sellers in a subject-to deal have their own set of objections.

**This Isn’t Enough Money!**

This is typically the biggest objection for subject-to sellers. A great way to field this objection is to get a full understanding of the question and then do a cost analysis together. Get out a sheet of paper and give them the calculator. Hand them the comps and ask what the average sales
Negotiating the Deal: Steps to Buying on Lease Options and Subject-To's

The price of the house is. They will calculate it and give you the figure. Then ask them what commission a Realtor gets in their area. Deduct the commission, then ask them what repairs need to be done to the house (and the cost) to bring the property up to current market standards. Then deduct those costs. Ask how long they think it will take to sell the house and then how long before the house closes. Add up the mortgage payments for that period and deduct those. Then deduct all the closing costs. Try to get them to put down anything else that will reduce the value more and help them be more realistic also—for instance, what is their time worth? As they do this themselves on the calculator it becomes hard for them to then argue about the value of their home. You are now working on something as partners, not adversaries.

Why Should I Give You the Deed and Control of the Property When I'm Left on the Hook for the Mortgages?

This is a legitimate question and one I would certainly be asking if the roles were reversed. And it demonstrates why it is so important to build rapport with the seller and make them feel comfortable with what you are suggesting. Remember, this will not work for everyone. To answer this objection, you might want to offer references or testimonials from other sellers. Here is how my friend Lyle Reichenbach from Phoenix would reply to this question:

“I can understand your concern, and I would probably feel the same way if I were in your shoes. All I can tell you is this: The bank will not let me assume your mortgage, and in order for me to make a fair return on this deal, I can offer you $___. I'll be glad to buy it right now at the price I've quoted, but then how would you cover the difference to pay off your current loan? You are actually being very savvy and getting top dollar for the property by letting me take over your payments; we both save all the costs that we'd incur—commissions, closing costs, and so on—if I were to just buy it from you. The minute you okay this paperwork, I kick into owner mode. I will be doing everything possible to sell this house as quickly as I can, using my expertise. I've spent thousands of dollars on training to do this business, legally and morally. It would be futile for me to let this property go back to the bank just because I didn't make the payments.”
I Don't Want Tenants in My Home.
This would get the same answer as with the lease option seller.

I Must Get the Price I'm Asking or I'm Not Selling.
Probably one of the most common challenges is getting the seller from “La-La Land” to reality! Here are some ideas on how to overcome the price objection.

Sellers usually think rigidly about pricing—they have a specific figure in their head. They tend not to think outside the box. But if a deal is properly structured, with the right terms, I can afford to pay full asking price.

First we have to verify that their asking price is within true market value. I usually accomplish this one of two ways. The easiest is to provide comparable sales in their area; sometimes you may want to delete the most expensive one from the list and recalculate. I've found more often than not that the highest-priced houses in the neighborhood are usually in A+ condition, having had new carpet, paint, and so on before they sold. The second way is to get the seller to buy an appraisal, which they would ultimately need even if they were able to sell retail as a FSBO. If you have an appraiser that you usually work with, simply let him know that contrary to normal, this time you're looking for as low an appraisal as possible. I've never had a seller balk at using a price that was in writing from an appraiser as a set point for negotiations. Unfortunately, appraisals can be misleading and bumped up in value, especially when done directly for a refinance or for a home owner, so a bit of caution on this: An appraisal is not a true indication of value.

Your explanation to the seller might go something like this:

“I understand that you feel the property is worth $XXX, but let me show you what is happening right here in your neighborhood. This house at 123 Main Street is 1,480 square feet with a pool and it sold for $XXX; all the homes on this list are within a few blocks of your house. Remember, these prices are what houses have sold for, not what someone is trying to get for a property. Based on these comparables, the program has calculated your house to be worth $XXX. I could be generous and pay you the price you want, but in order for it to make sense for me, I must get the following terms.”
Negotiating the Deal: Steps to Buying on Lease Options and Subject-Tos

Then spell out the terms you require. Remind the seller of the risk you are taking in assuming responsibility for the property, making payments, and waiting to make your profit at some future time.

I Want to Have My Attorney Look Over This Agreement.

This is reasonably common, normally just a ploy by the seller to stall and not make a final decision. Ask if there is something they don’t understand, and offer to go over it again to clarify it. Sometimes they want to just talk about it a little bit more and then they will sign the contract. Your goal is to get the seller to make a decision and get off ground zero.

I’m Thinking of Just Listing It with a Realtor.

This is usually another stalling tactic. You can reply: “If you would like to list your home with a Realtor, that is fine, but if you would like to sell it now, then you have a buyer here in your home and you won’t have to pay any commission. This is going to save you $XXX.” If they insist on listing it now, then make sure they put you as an “exclusion to the listing contract.” This will keep the Realtor from getting any commission on the home if the seller ends up selling it to you. However, don’t suggest this immediately, or the seller will see it as a risk-free trial offer to list it with a Realtor. Rather, the exclusion will be a last-ditch effort to save the seller a commission if they choose to list it with a Realtor anyway.

My friend Lyle specializes in subject-tos. He recommends the following to help:

At the onset, there are two critical things to do.

1. When the seller answers the door, I confidently reach out with a handshake and say, “Hi, I’m Lyle, I’m the Buyer you’ve been praying for!”

2. Typically the seller will want to give you a tour of their house. I politely but firmly say, “I appreciate your kind offer, but after looking at so many houses through the years, I prefer to just wander through by myself. If I have any questions I’ll ask them in a few minutes. In the meantime, please sit down and
look through my Seller’s Information Manual.” This is my credibility kit. On the front is a full-color photo with a banner stating “It Is Finished” and a giant “SOLD!” sign stamped across the front cover.

**Other Negotiation Points**

Here are a few more things you can work with in negotiating your deal.

**Seller Paying Part of Payment**

Many times you will find it necessary to ask the seller to make some of the payment in order for the deal to make financial sense. Usually this happens when a seller has taken all or most of their equity out through a second mortgage. These normally have higher interest rates and therefore higher monthly payments. I’ve asked sellers to continue to pay that second mortgage for some predetermined time, until either I can get the property resold or appreciation catches up. Bear in mind that the seller has either done some debt consolidation or spent that money on other things; in other words, they have already spent their equity. I use a form of promissory note from the seller to try to influence them to continue the payments. Obviously once you solve a seller’s dilemma, they can relax a little, and not all sellers will keep their word about making these payments on a house they no longer own. I’ve had a couple occasions where the seller did not make the payments as promised, but I kept the deal anyway because I was still in good shape. If you use the following approach, or something similar, it makes sense to the seller to continue these payments.

“I see you have two mortgages on the property. Why did you feel it necessary to take out a second mortgage and where was that money spent? Well, I can certainly empathize with you, but since you have already spent your equity for this reason, not only do you have no equity left, but in order for this deal to make financial sense to me, I’m going to need you to continue to pay only the second mortgage for the next two years.
I'll take care of the first, but as you already know, there is no way I can rent the property for the amount needed to cover these two payments. I won't even have enough to pay any management fees. If you were in my shoes, would you want to take all this risk for a negative cash flow? If I were in your shoes, I would not like to have to do this either. But look at it this way: Isn't it going to be more financially feasible for you to pay just $244 per month instead of the whole $1,179 you are paying now? If you step in and do your part, I'm willing and able to help you by taking the other $935 burden off your back. Together we've created a win-win situation now, don't you agree?"

Seller Paying You to Take Over Payments
If there is not enough room for profit in the deal, there may be a time when the seller will need to give you a sum of money for you to take over the deed.

Length of Term
I usually make sure, and my paperwork spells out the same, that the term could conceivably last the entire length of the note—although in reality that will probably never happen. Most of the time you will have sold the home before the loan is paid off. Sometimes, however, the seller does not need it out of their name or there are other circumstances that require it to be paid off in the length of time more in line with a lease option.

The Point at Which the Agreement Locks In
This is a negotiable point. You can have the seller make several more payments until you take them over. If you don't feel you can or want to take the risk of carrying those payments until you find a tenant-buyer, then put this type of provision in the contract.

Understanding some of the many ways to approach lease option or subject-to negotiations will equip you to creatively solve the seller's problems. There are so many times when one area of negotiation is
very important to a seller, like sales price, that we forget to negotiate the rest of the deal. Investors tend to walk away based on price alone. Many times we can end up with the same bottom line by negotiating the rest of the terms with the seller, if we take the time to work out the details. It is up to you and the rapport you’ve built with the seller to make it all a win-win situation!
Now that you’ve found a motivated seller who is perfect for a lease option, you’ve determined the technique, you know the profitability, and you’ve negotiated the deal, you will need to get the paperwork ready to be signed by the seller. For a lease option deal there are several contracts and forms that need to be signed: there are also more steps that need to be taken to complete and organize the deal. I use a checklist so that I don’t forget any step during the process and to ensure that all items are completed. A checklist is crucial when you are new at this or when you have many properties going at one time. With more experience you will know what needs to be done and likely not forget much, but when you are working on many properties at one time, there are things you can’t keep straight in your head, things that may slip through the cracks. A checklist will help you keep things straight on each property.

I have a checklist form for each property and I review them every day, or every other day, to see what needs to be completed for any of my properties. A task gets added to my to-do list when it is the appropriate time to work on it, and it doesn’t get checked off the list until it is completed.

Let’s take a look at the checklist I use for lease options.
BUYING ON AN OPTION—CHECKLIST

1. Create owner folder for this home
2. Order pretitle work
3. Check IRS/state tax liens
4. Check if mortgage is up to date
5. Check if property taxes are paid
6. Draft all documents:
   a. Rental Agreement/Lease
   b. Offer to Purchase/Purchase Agreement
   c. Option Agreement
   d. Memorandum of Option
   e. Affidavit of Liens
   f. Bank Authorization
   g. Seller's Disclosure
   h. Lead-Based Paint
7. Get a key or access
8. Get an inspection
9. Advertise the home
10. Set up utilities
11. Water reading (if city water)
12. Water softener (if well/rental?)
13. Get insurance (liability)
14. Owner's proof of insurance—additional insured
15. Review title work
16. Sign all documents
17. Record Memorandum of Option
18. Set up automatic payments if paying mortgage payment
19. Maintenance/work to be completed (list work that needs to be done):

   ______________________________________________________
   ______________________________________________________
   ______________________________________________________

   Address: ____________________________
   Contact: ____________________________
   Phone: _____________________________
   Projected starting date: ____________
Using the Option Checklist

If you have several properties, keep them filed in order of which ones are projected to start first. I would focus my attention on these and would also advertise them more heavily.

Fill out the information at the top of the checklist: the address of the property, owner’s name and phone numbers (how you will reach them—if there are several numbers, put them all down), and when the option is projected to start.

Now let’s go through the items on the checklist.

Create Owner Folder for This Home

I use a left-tabbed green folder (think green for money!). I set up an owner folder for each property that I buy on an option, outright, subject-to, and so on. I use right-tabbed red folders when I sell on an option later, to hold all the tenant-buyer information. All contracts, memos, notes, surveys, title work, or anything regarding the home will go into this folder. This is strictly for the information that involves the seller and you—nothing concerning the tenant-buyer will go into this folder. (Note: The folder doesn’t have to be green—just the tab part or the address.)

Order Pretitle Work

This can also be called a “commitment for title.” It is not to be confused with title insurance. You normally cannot get title insurance on property you don’t own, but you must do research to see what is on the title and if there are liens on the property. If you order this from a title company, it can take 7 to 10 days, maybe fewer if you have a relationship with the title company. You can also do it yourself if you are knowledgeable in your own state and county about what you need to
research and where to research. This is where you verify that the title is clear of judgments and liens.

Check not only the title liens but the state and IRS tax liens that might go against the person on title. If I go down to my county courthouse to research John Jones on 123 Anystreet, I might only find a mortgage on title, because IRS information is kept at a separate location. However, a title company will pull the information from all relevant sources to give you a complete picture. If there are liens other than the seller's mortgage, this would indicate the seller is not a good candidate for a lease option but rather a subject-to, because this would be considered bad debt on the property.

The title work will also show all owners of the property. It is very important that you purchase the property from all its owners. Sometimes I have looked at title work and seen “Joe and Sally” on the title when Joe had said he owned the property. Joe forgot to mention that he had divorced Sally. The problem with this situation is that Sally is still on the deed/title of the home. Sally either has to get off the title by deeding her interest to Joe or agree to all the terms of the lease option and sign the paperwork. Whoever is on the deed/title must sign. I also recommend that married people have their spouses sign the documents too. In many states a married man must have his wife sign the deed in order to transfer title, even if she is not on the title, because of her dower rights. However, I recommend that anyone who is married have their spouse sign the agreements.

**Check IRS/State Tax Liens**

Usually the pretitle work will show these liens, but if you are doing your own research make sure you check for both of these areas. Ask someone at the county office to help you confirm that the seller does not have any IRS or state tax liens against them.

**Check If Mortgage is Up to Date**

The best information source for the mortgage is the seller. Many mortgage companies will give their seller a statement each month to show what has been paid, what is still owed, and whether any payments are late. If the seller does not have a current account statement, they will have to order one. If taxes and insurance are escrowed in their monthly payment, then you will also know that those are cur-
Getting the Paperwork Ready for a Lease Option Deal

rent—a mortgage company would not let those go unpaid or be delinquent. (An escrowed payment is a payment that includes the taxes and insurance as part of the monthly payment.)

Check If Property Taxes are Paid

You can call your local county or state building and get proof that taxes are paid. Find out in your state or area how to confirm that all property taxes are current on the home. Call your local city assessor’s office and ask them about the home. In some states any back taxes might be paid by the county, and the city might not know whether the taxes are paid, so confirm with the assessor and possibly other real estate investors in your area as to how you will know if they are paid up to date. You can also ask the seller to provide proof by showing you a recently paid tax bill; however, that won’t mean that a tax bill from two years ago was paid. Find out and protect yourself.

Draft All the Documents

To make a lease option work, three main agreements are needed. It is possible to roll all three into one or two contracts, but I like to keep them separate to make it clean and clear. It is especially important to keep them separate when you sell on an option (see Chapter 13).

1. The Option Agreement. On the selling side, the option agreement turns control of the property over to the optionee without ownership. When I am doing a lease option, I sign an option with the seller and they give me control for a specified amount of time (usually 2 to 5 years), during which I will be trying to secure a tenant-buyer for their home.

2. The Rental Agreement. The rental agreement specifies how long I will rent their home and how much I will pay them each month for the rental. The rental payment will always go first to their mortgage company, if any mortgage is due on the home, and then to the owner if any rent is remaining. For example, if my rent is $1,200 per month and the mortgage payment is $1,300, the mortgage company will get $1,200 from me and $100 from the owner. If the mortgage payment is $1,200 then the mortgage company will get one check from me for $1,200. If the mortgage payment is $1,100 then I
will write one check to the mortgage company for $1,100 and one to the seller for $100. The check to the mortgage company must have the mortgage account number on it so that it gets applied to the correct mortgage. (The owner could have two mortgages with the same mortgage company.) Protect this mortgage and make sure that it is getting paid.

3. The Purchase Agreement. This agreement sets the terms of the final sale. Again, there are two of these—one for my deal with the seller, and one for my deal with the tenant-buyer. The deal with the seller has a set sale price, which remains constant regardless of appreciation or even depreciation. However, it is always negotiable up front. For example, you could agree that the price is $150,000 if purchased within two years and $155,000 if purchased between years two and five.

There are five other forms that the seller will need to sign.

1. Memorandum of Option. This is the document that gets recorded against the title of the property. It does two things. First, it gives the world notice that you have an interest in the property by "clouding" the title. When you cloud a title, the seller can't refinance or sell the home to someone else and give clear title. A reputable title insurance company would not insure it with this memorandum on the title. This document protects your interest in the property and it is very important that it gets recorded. Having it signed and notarized does you no good—recording it is a necessary step.
Getting the Paperwork Ready for a Lease Option Deal

Secondly, it seasons the title. *Seasoning* is a term that is becoming more and more important to real estate investors. Mortgage underwriters are becoming very strict about the length of time investors or sellers must have owned properties before selling them. There has been so much mortgage fraud in the past few years that the mortgage industry is really cracking down on this, and one way to do it is to make sure that the seller of a home has owned it in their name for 90, 120, even 360 days. Each lender has their own requirements for the number of days to season a title of a property. This is important to be aware of in a lease option strategy, as a lease option is not ownership. You will be selling a home later that you did not own, except for maybe one hour or so. This may be a problem for some lenders, but for most, filing the Memorandum of Option will season the title adequately for them. As I write this book, FHA is the only lender that I know of that will not approve a Memorandum of Option as seasoning. These guidelines and rules are changing constantly, and something you should check into. (The real estate investing world hadn’t heard of the word *seasoning* when I started in 1985.)

2. **Affidavit of Liens.** This is a sworn statement, signed by the seller, that disces all of the liens on the home. It also asks about liens that are not yet recorded but known about; for example, if the roof was replaced last month but the roofer has not been paid yet, this could become a lien. The seller must disclose it or be guilty of fraud.

3. **Bank Authorization.** This document gives you authorization to get information about the mortgage. You can find out at any time the status of the mortgage, balance, payment history, payoff amount, and so on. It gives you authority to find out information from the mortgage company as if it was your own mortgage. Because all payments made in the future should be made directly to the mortgage company and not to the seller, you will want access to the seller’s mortgage information. This will protect you from having this home go into foreclosure.

4. **Seller’s Disclosure.** This is a statement the seller fills out that discloses the condition of the home. The seller must disclose any problems with the home. Each state has different Seller’s Disclosure statements. Ask a local Realtor for a blank Seller’s Disclosure statement for your state.
5. **Lead-Based Paint Disclosure.** This disclosure is a federal requirement in the sale or rental of any home. Prior to 1978, lead was a component of paint products used in residential homes. Lead poisoning has caused many problems for people, but primarily permanent damage to children. Therefore the Department of Housing and Urban Development (HUD) passed a law requiring sellers and landlords to have the lead-based paint disclosure signed and to give the pamphlet called “Protect Your Family from Lead in Your Home” to all potential buyers and tenants. If this step is not completed, the fines are significant. Also, if lead-based paint is present in your home and you don’t do this step, you can be sued if a child is later found to have suffered brain damage from your negligence. Some states require that you completely remove lead-based paint from your rental homes. Check out your state’s lead abatement requirements. You may want to avoid those homes or confirm it has been completed prior to your taking it over.

**Get a Key to the Home**

Make sure that you have a key or accessibility to the home. If the home is listed through a Realtor, you may be able to get the lockbox combination and have access to show the home anytime, if it is vacant. If the seller is still living in the home, which is often the case for me, I make sure that I either have the ability to call the seller and make an appointment for a showing or that the seller gives me a key and I give them a courtesy call to let them know when I am going to be showing it. If the seller gives you a key, consider keeping it in a lockbox at the house. You can purchase one at most hardware stores.

**Advertise the Home**

Get the home advertised as soon as you know it has passed your inspection, or even before. You want the period of vacancy to be minimal. Advertise it in the newspaper, with local employers, on a web site, etc. Advertise anywhere you can find a buyer. (See Chapter 12 for more detailed tips on advertising.)

**Set Up the Utilities**

Do this when you are about to take possession of the property. For example, if it’s April 28 and I’m taking the property on May 1, I will go
ahead and turn on the utilities in my name (electricity, water, gas, etc.). Turn on anything that is required to be in your name and out of the seller's name. Be especially careful about winter months in cold parts of the country—you don't want any days to go by without heat. I have discovered ice skating rinks in a few of my homes over the years, because the heat was not turned on.

**Water Reading**

In some cities and municipalities, a water bill can be a lien against the home if not paid, so get a final reading to make sure it's current and paid from the day that you take possession from the seller. Also, have the water bill mailed directly to you. This way you can either pay it and bill the tenant, or forward the bill to the tenant and know that it is getting paid.

**Water Softener**

If there is a water softener on the property, make sure you are taking care of it. If it's a rental softener unit, change that contract over to your name. I have a water softener company that I work with, and I will set up a lease to own on the softener equipment. The tenant actually pays the bill, and if they end up not exercising, at the end of their lease the water softener belongs to me. Having a water softener is critical if you have hard water. Most properties with city water will not need a water softener.

**Get Liability Insurance**

Since you don't own the home, you can't actually insure it. However, you have a liability issue just by being the landlord of the home. As far as the tenant is concerned, you are the landlord, and as far as the owner is concerned, you are the tenant. So you have both tenant and landlord roles without even owning the property. I recommend purchasing some type of commercial general liability policy that would cover you for properties you don't own. This is not going to be a make or break on your first deal or two if you do step 14 on the checklist, but it's something you should consider if you're going to stay in this business. Talk to an insurance agent to get educated, but
do get several opinions and quotes. Some will try to sell you more insurance than you need.

**Owner's Proof of Insurance**
Make sure the owner has insurance on the home itself. If they have a mortgage, the mortgage company will require it, but if they own it free and clear they may not have insurance. Also make sure that on the insurance policy they name you as an additional insured. Some insurance companies will not want to put you on their policy without you being an actual lien holder (like a mortgage holder—see the “Performance Mortgage” section in Chapter 9 for a way to accomplish this). My rental agreement and my offer to purchase require my owner to list me as an additional insured on their homeowner's policy. They might have to switch insurance companies to find a company that will do this. There are several benefits of being an additional insured: (1) You get liability protection; (2) you should get notified if the seller cancels their insurance policy for any reason, even nonpayment; and (3) you probably will be on any settlement check if the home burns down or any other disaster occurs. Being an additional insured is a great thing, but it should not usually be a deal breaker.

**Review the Title Work When It Comes Back**
Check for liens and for ownership; make sure the title is clean and clear. You want no surprises. Do understand, however, that some things can show up on the title work in error. I have had several titles show up with old mortgages on them, where it appears that the owner has two mortgages. Don’t assume the owner is hiding something from you—ask them about the mortgages showing up on the title work. Many times the owner had refinanced the home and the old mortgage didn’t get discharged properly. Don’t be alarmed, just get the old one cleared up. The title company can help you with all of this.

**Make Sure All Documents Are Signed by the Seller and by You**
Have two complete, signed sets: one for them and one for you.
Getting the Paperwork Ready for a Lease Option Deal

Wendy’s Tip

I always recommend having a witness when you are signing a document, but a witness is not necessary to make it valid. Only the Memorandum of Option needs to be notarized so that it can be recorded.

Record the Memorandum of Option

This is usually done at the county building. Once you are certain that you are going to move forward with the deal, if you’ve got a start date coming up or if you’ve got a buyer for the property, then you want to record the Memorandum of Option. This will get recorded against the title. It then shows the world that you have a claim against the property and that you have the right to buy it on an option.

Wendy’s Tip

Make certain that you leave a 2.5-inch blank margin at the top of your Memorandum of Option or it will not be able to be recorded. Check your state/county recording requirements prior to completion of this form.

Set Up the Payments with the Seller

You can set up an automatic payment with the mortgage company that goes directly out of your bank account. I use Quickbooks for mine. This eliminates the risk of forgetting to write the checks out in a timely fashion.

A List of Maintenance or Work to Be Completed before I Take Possession

This is a list that either you or the seller are responsible for, depending on what deal you have made with the seller—things like replacing linoleum, repainting trim, replacing the mailbox. All repairs are to be done by my contractors (so I can control the quality) unless otherwise
STEPS TO BUYING PROPERTIES

Memorandum of Lease Option

Optionor, whose address is ___________________, and “Optionee” (your company name or personal name), whose address is ___________________, entered into an option “the Option” dated as of _______________, pursuant to which Optionor has agreed to option to Optionee the right to purchase certain real property “the Property” located in the ___________ of ____________, County of ____________, State of ______________, more particularly described as (insert legal description here—this is needed to record the home).

The Option requires that Optionee shall exercise the Option on, or before, ________________, or the Option shall expire. While the Option is in effect, Optionor may not assign, convey, lease, sell, transfer, mortgage, or otherwise encumber the Property or any part thereof, nor shall Optionor do, suffer, or permit any act, deed, or omission which might diminish or encumber the rights of Optionee or the ability of Optionor to perform obligations in accordance with the terms of Option.

IN WITNESS WHEREOF, the Parties have executed this Memorandum of Option on __________________________.

Optionor:

_____________________________________

_____________________________________

Optionee:

(Your company name here)

A (your state name) Limited Liability Company

Its Member:

_____________________________________

Its Member:

_____________________________________

State of ______________

County of ____________

The foregoing Instrument was acknowledged before me on this ______ day of ____________, 20_____, by ______________________ and ______________________.

_____________________________________

Notary Public, ______ Your county & state

My commission expires: _______________
specified. All repairs, both major and minor, are the responsibility of the tenant except during the first 60 days of the agreement—I leave that responsibility to the owner. For instance, if the furnace went out two days after I took possession, I don’t want to be responsible for that. Everything is negotiable, and while 60 days is my standard, it’s completely flexible. You can make it longer; you can also make the seller responsible for all repairs, for anything over $500, for anything under $500, for nothing at all—structure it the way you want it.

Wendy’s Tip

When juggling the receiving of the rent from the tenant and the payment of the mortgage to the owner, you might want to stagger them a few days to give the tenant’s payment time to clear before you make a payment to the owner.

Some of My Favorite Clauses

Each state may require certain information for your rental agreements and purchase agreements. I offer contracts on my web site that are generic and can be used in all states, but these should always be
checked by a local attorney, because each state has its own unique laws. Attorneys can be very expensive. I use Pre-Paid Legal services, which offers plans starting at very reasonable monthly rates to give you legal assistance. I have been a customer since 1998 and have saved thousands of dollars as I obtained help on legal questions, contract reviews, letters, and so on for real estate matters in multiple states. You can find out more at www.prepaidlegal.com/hub/wendypatton. Each state has their own rules and regulations regarding rentals, lead-based paint abatement, evictions, and so on, so some of the following clauses may not apply to your situation, depending also on what you have negotiated with your seller. These are just some examples of things I have used with my sellers, some of the clauses that have been my favorites over the years in my contracts to buy on lease options:

*The Option Agreement*

- There shall be an additional option consideration of $____ per month given by Optionor to Optionee as credit towards purchasing the home.
- Optionee has the right to multiple-list, advertise, or resale this property before or during the option period.
- Should the property become uninhabitable at any point during the lease period, the tenant will be released from all rent liabilities until the property is habitable and is re-let. The period of time that the home is uninhabitable will be added to the Option Agreement and attached Rental Agreement and Offer to Purchase.

*The Rental Agreement (Lease)*

- Tenant will have access to the home on ____ to show the property to prospective tenant-buyers and contractors.
- Tenant will be assigning this agreement to another party, but is still responsible to the owner per this agreement.
- The owner gives the tenant the right to make repairs/improvements to the property at the tenant’s expense. All repairs and improvements will be done with the tenant’s contractors.
Getting the Paperwork Ready for a Lease Option Deal

- Landlord agrees to use their homeowner's insurance to cover any items/repairs/damage that would be covered under their policy (i.e., storm damage, fire, etc.) since tenant can’t utilize their insurance for these type of repairs.

The Purchase Agreement (Offer to Purchase)

- Purchaser will put $_____ down on this property. Check will be written directly to (realty company of listing office) upon execution of the attached rental agreement. This amount will be applied directly to the purchase price at closing, and to any listing commission owing. The remaining commission, if any, will be paid at closing out of seller's proceeds to the appropriate offices.

- Seller agrees to change their homeowner's insurance policy to a non-owner occupied policy and to name the purchaser as an additional insured within three days of purchaser taking possession of the home.

The paperwork is vital to your successful ability to make a lease option deal, so don’t skip any steps, and make sure all areas of the checklist are covered. You will add your own favorite steps and clauses over the years as you do lease options and learn new ideas.
The contracts and forms for a subject-to are different from those for a lease option. Again, I use a checklist so that I don't forget any step during the process and I make sure that all items are completed. You should have a separate checklist for each subject-to property.
Getting the Paperwork Ready for a Subject-To Deal

Buying on a Subject-To—Checklist

1. Create owner folder for this home
2. Order pretitle work
3. Check IRS/state tax liens
4. Check status of mortgage(s)
5. Check if property taxes are paid
6. Draft all documents:
   a. Offer to Purchase/Purchase Agreement
   b. Warranty Deed
   c. Seller’s Acknowledgments
   d. Affidavit of Liens
   e. Bill of Sale
   f. Escrow Payoff
   g. Notice to Insurance Company
   h. Limited Power of Attorney
   i. Notice to Mortgage Company
   j. Bank Authorization
   k. Seller’s Disclosure
   l. Lead-Based Paint
7. Get a key or access
8. Set up my insurance policy
9. Review title work
10. Get an inspection
11. Advertise the home
12. Set up utilities
13. Water reading (if city water)
14. Water softener (if well/rental?)
15. Sign all documents
16. Record deed or land trust
17. Bring mortgage(s) current
18. Set up automatic payments if paying mortgage payment
19. Maintenance/work to be completed (list work that needs to be done):
**STEPS TO BUYING PROPERTIES**

**Using the Subject-To Checklist**

If you have several properties, keep them filed in order of which ones are projected to close with the owner first (which ones have money owed to the bank first). These are the ones where I would focus my attentions first. I would also advertise them more heavily.

Fill out the information at the top of the checklist: The address of the property, current owner's name and phone numbers (how you will reach them—if there are multiple numbers, put them all down), when you are projected to start the subject-to, and all of the lender information. There might be two mortgage companies, and you will want to put all information down on each of them; contact numbers, loan balance, and loan/account numbers.

**Create Owner Folder for This Home**

This is a green folder, in contrast to the red tenant’s folder.

![123 Any St.](GREEN: SELLER)

**Order Pretitle Work**

This can also be called a “commitment for title,” but it is not to be confused with title insurance. You probably won't be able to get title insurance on property that has a loan on it (there are a few companies that will give you title insurance subject to the current mortgages, so do shop around). You may need to rush this title work if you are doing this deal quickly. If you order it from a title company, it can take 7–10 days, maybe less if you have a relationship with a title company. You can also do it yourself if you are knowledgeable in your own state and county about what to research and where. Refer to the corresponding section in Chapter 7 for more information on pretitle work.
Getting the Paperwork Ready for a Subject-To Deal

Check IRS/State Tax Liens
As stated in Chapter 7, usually the pretitle work will show these liens, but if you are doing your own research, ask for help in checking both of these areas to help confirm that the seller does not have any IRS or state tax liens against them.

Check Status of the Mortgage(s)
Require that the seller get proof from their mortgage companies concerning the status of the mortgages. Don't go by their word—get it in writing or on the phone directly from the companies. You will want to know exactly how much they are behind, if at all. Some sellers are not behind at all on a subject-to or have only one mortgage, but you want to make sure. Confirm all the information they give you. A recent mortgage payment statement might show the exact information, but some mortgage companies don't mail out statements. Because you will be the owner on a subject-to once the seller signs over everything, if you missed something in these steps you will be stuck with it later.

Check If Property Taxes Are Paid
You will want to confirm exactly where the taxes stand on a subject-to deal. Sometimes you will be taking over back taxes, and sometimes there are none due. You need to know the exact numbers so you know your bottom-line profit and out-of-pocket expenses.

Draft All Documents
1. Offer to Purchase/Purchase Agreement. As in Chapter 7, this is a full contract describing the terms of the purchase.
2. Warranty Deed. This puts your name on the title to the home.
3. Seller's Acknowledgment. With this document the seller acknowledges important things about the sale of their home. This way they can't come back later and say they didn't understand what they were doing or didn't realize they were really deeding their home to the investor.
4. **Letter for Due on Sale Clause.** This informs the seller that their home still may be called due, that the investor is not guaranteeing they will pay the loan off in full, and that the owner accepts this risk in selling their home subject-to.

5. **Affidavit of Liens.** This is a sworn statement in which the seller discloses all of the liens on the home, whether recorded or unrecorded.

6. **Bill of Sale.** This document lists all of the personal property to be included in the sale, such as appliances, window coverings, and anything else you want to ask the seller to include in the sale of the home.

7. **Escrow Payoff.** This document authorizes the bank or mortgage company to give you, the investor, any money remaining in the escrow account when the mortgage is paid off. Without this document, the mortgage company will pay the seller any proceeds left after a mortgage payoff because their name is on the mortgage even if it is not on the deed.

8. **Notice to Insurance Company.** This informs them of the land trust or other transfer.

9. **Limited Power of Attorney.** This gives the investor power to act on the owner's behalf as it pertains to the home in question, but it does not give the investor power to act on the owner's behalf on any other matters. An example of this document is shown in Chapter 9.

10. **Notice to Mortgage Company.** This informs them of the transfer of ownership of the home, if you are telling them outright. If not, you will still want to notify them of a change in address for mailing of mortgage payments, year-end interest, and so on.

11. **Bank Authorization.** This document gives you the right to call the bank or mortgage company and get any information on the mortgage, including loan balance, loan history, payoff information, payoff request, escrow balance, and the like.

12. **Seller's Disclosure**—described in Chapter 7.

13. **Lead-Based Paint Disclosure**—described in Chapter 7.
Getting the Paperwork Ready for a Subject-To Deal

Get a Key or Access
This is described in Chapter 7; it works the same in a subject-to as in a lease option.

Set Up Your Insurance Policy
There must be an insurance policy on the home that matches the owner's name, and you are the new owner. This is for your protection and is also a mortgage requirement. If you can have the seller's policy changed to your name, that would be the best; however, you might need to purchase a new insurance policy.

Review Title Work
Make sure the title work shows the owner of record and the liens that you expected.

Get an Inspection
Just like with a lease option or any other real estate purchase, you should complete a home inspection. Make your offer to purchase contingent upon a good home inspection. This will allow you to get out of the deal if you find too many things wrong with the home or something that would be too expensive to fix. You can always go back and renegotiate if you find something wrong, but not if you don't have this clause in your contract.

Advertise the Home
Once you think this home is going to be purchased on a subject-to, start to get it ready for a lease option to sell. Put the ad in the paper to get it rented to a tenant-buyer.

Set Up Utilities
Set up all utilities when the seller is out of the home. Make sure you know what utilities are used there—gas, oil, propane, electricity, what trash removal company, and so on.

Water Reading
Make sure you do a water reading (ask the city if they do it or if you have to do it) and check to make sure the water bill has been paid. In
many parts of the country, the water bill can become a lien on a home. You might not even know it is a lien until months after the seller has moved out of town.

**Water Softener**
If there is a rental water softener unit, make sure the rental payments are current. If the seller owns it, make sure it is part of the Offer to Purchase and listed with all of the other appliances in the home.

**Sign All Documents**
Get all documents signed. The Limited Power of Attorney and the Warranty Deed will need to be notarized. The rest should be witnessed. It would be best to do them all at one time.

**Record Warranty Deed**
You will record the deed, usually with the county registry of deeds or clerk’s office. You will record it when everything is signed and all of your due diligence is completed and all of your other contingencies have been satisfied.

**Bring Mortgage(s) Current**
Once the documents are signed and the land trust is recorded, then you should bring the mortgage current, if necessary. If the seller is in pre-foreclosure, get the funds wired to the lender immediately. If they are just a month behind, you can send the payment by ordinary mail. Just make sure your check clears and you get a receipt and proof of the payment on the next statement.

**Set Up Automatic Payments If Paying the Mortgage Payment**
Do something to make sure you don’t forget to make those payments on time each month. I set mine up in Quickbooks to be paid at the beginning of the month.

**Maintenance/Work to Be Completed**
Make a list of repairs and other work that needs to be done on the property.
Some of My Favorite Clauses

Seller’s Acknowledgments

- We may be selling the property below market value, but because of our personal circumstances and the immediate need to sell, we are satisfied with the price that we have negotiated.
- We understand this sales contract is final and binding upon all parties. We are bound by the conditions and terms described in the attached offer to purchase.
- We understand that the purchaser is a real estate investor and intends to resell the property at some future date and expects to make a profit.
- We are not signing this contract under duress and have signed this agreement of our own free will, without undue financial pressure. The buyer has in no way pressured us into signing the agreement.

John Hyre, a tax attorney, is involved in many real estate transactions. He uses the following form for his subject-to deals.

Summary of Our Deal

- You are selling me your house. It is mine now.
- The mortgage to the house is staying in your name and on your credit report.
- I do not intend to refinance the mortgage, though I may one day choose to do so.
- If the bank calls the loan due, as is its right, I will not refinance the loan. As such, the bank could foreclose on the property if it calls the loan due. That would hurt your credit.
- I will make the payments on your mortgage in full, on time, every time. That is the payment that I am giving you for the home.
- I will pay arrearages on the mortgage in the amount of $__________.
I will also put $_______ of repairs into the house to make it rentable or saleable.

This deal is FINAL. You do not get the house back. The loan stays in your name until such time as I should see fit to pay it off at my sole discretion. You will NOT contact any tenants to whom I rent the house.

The benefits to you:

- A bad house that is going to foreclosure/costing you money/ruining your credit will be off of your hands. The financial bleeding stops right now.
- Your credit will be helped over time by my on-time payments.

The risks to you:

- The loan could be called due by the bank and foreclosed upon.
- The presence of the loan on your credit report could limit your ability to take out future loans.

The benefits to me:

- Like you, I expect to be paid for my work. I intend to profit by selling or renting the house. I have purchased it at a favorable price and/or on favorable terms to make a profit.
- The loan stays in your name, so I do not need to get one in my name, pay closing costs, etc.

The risks to me:

- Tenants could trash the house, in which case I’d have to pay for repairs.
- Tenants could skip out or the house could sit empty, but I still need to make the payments on your loan.
- The house could sell or rent for less than I’d planned, but I’m still on the hook for the payments I promised to make.
Getting the Paperwork Ready for a Subject-To Deal

- The bank could call the loan due and I could then lose whatever I put into the house.
- The repairs could cost more than I’d planned.

The paperwork is vital to your successful ability to make a subject-to deal work smoothly, so don’t skip any steps. Make sure all areas of the checklist are covered. You will add your own favorites through your own experiences with subject-tos as you learn new ideas and master the concepts.
While I have suggested strategies that you should start with, there are more advanced lease option and subject-to strategies available to help you build your portfolio. These are things I have learned from other students, national speakers, and my own experience. You can succeed with just the basic concepts, but these topics will broaden your capabilities and elevate your business. The strategies shared in this chapter include additional ways to protect yourself and additional methods to increase your profitability on each deal.

Remember that all of your strategies must be negotiated before any paperwork is signed. You will need to determine which, if any, of these strategies make sense for each individual situation. Some of these techniques may be viewed by certain sellers as intimidating or overly complex. Therefore you will need to know your seller and understand them by building the relationship, as discussed in Chapter 6.

**Extra Ways to Protect Yourself in a Lease Option**

As a lease option holder you are dependent upon the good faith performance of the seller who holds title to the property. In Chapter 7 we
discussed protecting yourself by filing a Memorandum of Option. In this section I discuss some additional techniques to protect yourself and strengthen your position.

**Place a Deed in Escrow**

This approach can be used along with the filing of a Memorandum of Option. The seller would actually sign the deed at the same time that they sign all of the lease option contracts. However, the deed is not yet recorded on the title. Instead it is held in escrow by an attorney or title company with instructions for its release. While this approach does not protect the title against the potential filing of liens, it tends to give sellers the feeling that they have deeded, or sold, their property, so they are much less likely to try to back out later on their lease option agreement. It can also allow the investor to close on the home without the seller being present.

The instructions included with the deed in escrow specify how and when the deed can be released and recorded. For example: “When Wendy Patton pays $155,000 in certified funds to Joe Smith, this deed can be released to her. These funds must be paid by ___.”

**Performance Mortgage**

This device would replace the filing of a Memorandum of Option. A performance mortgage strengthens your ability to ensure performance by the seller by having the seller pledge the property as collateral for the lease option agreement. It is recorded at the time the lease option agreement is made. Signing a mortgage to you protects you against them selling to anyone else.

Like the Memorandum, it allows their insurance company to put you on the owner’s policy as an additional insured, and it shows you as a lien holder for any type of foreclosure so you should be notified of any proceedings.

While this is a good concept that strengthens your position, many sellers find signing it objectionable, so you may not be able to use it in every case.

You’ll want the specific terminology to be reviewed by a local
real estate attorney, but here are some of the key performance mortgage clauses:

- This indenture, made this __________ day of (month), (year) between the Mortgagor (name of optionor), and the Mortgagee, (name of optionee), whose mailing address is: . . . .

- Whereas, the said Mortgagor has executed a certain Option Contract agreement dated _____________ under which Mortgagor is obligated to the said Mortgagee to deliver fee simple and clear marketable title to that certain parcel of real estate, legally described below, which obligation is attached hereto and by reference herein made a part hereof. . . 。

- To secure to the Mortgagee the compliance and performance of the Mortgagor in meeting both the letter and the spirit of the agreement evidenced by said Option Contract, (name of optionor) does hereby mortgage, grant and convey to Mortgagee the following described land, situate, lying and being in the County of __________, State of __________, more particularly described as (legal description). . . 。

- Provided that if Mortgagor, heirs, legal representatives, or assigns, shall with the agreement evidenced by said Option Contract, dated _____________, perform and abide by each of the agreements and conditions of said Option Contract and of this mortgage, and shall duly pay all taxes, costs, and expenses, including reasonable attorney’s fees, which the Mortgagee may incur in enforcing the Option Contract secured by this mortgage, then this mortgage and the estate hereby created shall cease and become null and void and the Mortgagee shall deliver to the Mortgagor an executed satisfaction of this Mortgage in recordable form.

- Mortgagor shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, and any other hazards, including floods or flooding.

- Unless Mortgagee and Mortgagor otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the property damaged. If the restoration or repair is not economically feasible or Mortgagee’s security would be lessened,
Advanced Concepts and Strategies

the insurance proceeds shall be applied to the sums secured by this Security Instrument with any excess paid to Mortgagor.

• The proceeds of any award or claim for damages, in connection with any condemnation or other taking of any part of the property, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Mortgagee.

Extra Ways to Protect Yourself in a Subject-To

Chapter 8 suggested several ways of protecting yourself in a subject-to deal, but there is another useful technique to consider: a land trust.

Land Trust

This device is used to minimize potential exposure to litigation by hiding true ownership. The actual owner or beneficiary of the trust is not recorded. Only the name of the trust is recorded in public property records. Thus, the extent of the beneficiary’s property holdings is not apparent and not a magnet to potential litigants. While the document is somewhat lengthy, I’ve listed some key clauses of the trust agreement here:

• This agreement and declaration of trust is made and entered into this (date) by and between (beneficiary name(s)) as Grantors and Beneficiaries (hereinafter referred to as the “Beneficiaries,” whether one or more, which designation shall include all successors in interest of any Beneficiary), and (trustee name(s)), whose address is ______________ (hereinafter referred to as the “Trustee,” which designation shall include all successor trustees).

• The Beneficiaries are about to convey or cause to be conveyed to the Trustee by deed, absolute in form, the property described in the attached Exhibit A, which said property shall be held by the Trustee, in trust, for the following uses and purposes, under the terms of this Agreement and shall be hereinafter referred to as the “Trust Property.”
The persons named in the attached Exhibit B are the Beneficiaries of this Trust and, as such, shall be entitled to all of the earnings, avails, and proceeds of the Trust Property according to their interests set opposite their respective names.

The interests of the Beneficiaries shall consist solely of the following rights respecting the Trust Property:

- The right to direct the Trustee to convey or otherwise deal with the title.
- The right to manage and control the Trust Property.
- The right to receive the proceeds from the rental, sale, mortgage, or other disposition of the Trust Property.

The foregoing rights shall be deemed to be personal property and may be assigned and otherwise transferred as such. No Beneficiary shall have any legal or equitable right, title, or interest, as realty, in or to any real estate held in trust under this Agreement, or the right to require partition of that real estate, but shall have only the rights as set out above, and the death of a Beneficiary shall not terminate this Trust or in any manner affect the powers of the Trustee.

The interest of a Beneficiary, or any part of that interest, may be transferred only by a written assignment and delivered to the Trustee.

Powers of Trustee including:

With the consent of the Beneficiary, the Trustee shall have the authority to hold the legal title to all of the Trust Property, and shall have the exclusive management and control of the property as if he were the absolute owner thereof, and the Trustee is hereby given full power to do all things and perform all acts which in his judgment are necessary and proper for the protection of the Trust Property and for the interest of the Beneficiaries in the property of the Trust, subject to the restrictions, terms, and conditions herein set forth.

This trust may be terminated at any time by the Beneficiaries, and with thirty (30) days written notice of termination delivered to the Trustee, the Trustee shall execute any and all documents necessary to vest fee simple marketable title to any and all Trust Property in Beneficiaries.
Advanced Concepts and Strategies

The trust document further defines the duties, compensation, liabilities, and other dealings with the Trustee. The document is then signed, witnessed, and notarized.

Additional Creative Ideas and Strategies

Here are some other strategies I have found useful. No doubt you will discover more as you gain experience using lease options and subject-tos.

Nursing Homes

It may sound morbid to you, but consider this in the states where older people can keep their home and be on Medicaid, but can't keep much money. If the person on Medicaid were to sell their home, Medicaid would take the proceeds; however, if they keep their home until they pass away, then their estate can keep the proceeds from the home. This may change in the future in many states, but some states still allow older people on Medicaid to keep their homes when they have moved into nursing homes. If the person can keep their home, this is a good possibility for a lease option on the seller side, but on the tenant side it can be no more than a rental situation since the owner is still living. In other words, you could not actually sell it to a tenant-buyer, you could only rent it until the owner passed away. In this case, your option agreement might be based on the death of the person.

This is a great way to make cash flow in the meantime, because the owner actually would not get to keep rental proceeds either—that would also go to the state. Therefore, you may also be able to negotiate a great rental rate, as it does not really affect the owner. The owner is happy, the renter is happy, and you're happy with the cash flow. Someday you will be able to buy this home, and it could appreciate significantly during this time period. The estate does not have to pay utilities or maintenance during all those years while their loved one is in the nursing home. Those responsibilities can be a huge financial and emotional stress on some families. The freedom of not
having to worry about the monthly expenses and yearly taxes can be an immense relief for many families in this situation. They will still get the money from the sale after the death of the loved one, but without you, they might have to sell the home because they can’t afford to keep it. This can truly be a win-win.

**Limited Power of Attorney**

In many states the transfer fees (the costs to record a deed) are extremely high, and doing a simultaneous closing (discussed in Chapter 15) becomes expensive. In some states the fees can be as high as 3 percent of the sale price of the home. On a home priced at $400,000 this would take an extra $12,000 in profit right off the top of each deal for investors in those states. There are two ways around this.

1. You can have the seller sign a new purchase agreement with your buyer for a higher amount, and you pay the difference in fees for what you paid the seller versus what you sold it for to your buyer. For example, if you paid $350,000 to the seller and you sold it for $400,000, you would have the seller sign a new contract with your tenant-buyer for the $400,000 and you would pay the extra costs on the $50,000 increase in price. This is fine if you don’t mind and the seller doesn’t mind the entire deal being laid out in front of them. Sometimes it is no big deal, other times it causes bad feelings. The seller already knew you were making a profit, but to put it in front of their faces can diminish their joy in the deal that once was a win-win for them. You can also offer to give them a little bonus with this. For instance, let’s say they were going to receive $95,000 in cash at closing. If they sign this document, now you will give them $96,000 at closing. It now becomes more of a win-win. They get more money and so do you. You only pay $1,000 for the first $250,000 in closing costs and then your state’s transfer fees and title insurance fees on the additional $50,000 on the raised price.

2. If you decide you don’t want the seller to see the details, or if they are out of state anyway, you can have the seller fill out a Limited Power of Attorney. This would allow you to sign documents on their behalf for this home at closing. You can then change the price to the new price, and sign on their behalf. It is completely legal and legitimate as
long as they get the amount they were supposed to receive at closing. The seller will receive a larger 1099 on the sale of their home, so they will need to be aware that it won't affect them taxwise. Talk to a CPA. They will have to sign a payoff letter prior to closing for the title company or attorney. It might have to have the dollar figure of payoff versus the sales price. In other words, it might say something like this:

To Whom It May Concern:

I am to receive $ ______ in my closing with Wendy Patton (subtract the closing costs and figure out what they should receive). Please mail my check to __________. Call me for any questions at (111) 222-3333. I will not be present at the closing, but Wendy will be signing the documents on my behalf, for which I have signed a Limited Power of Attorney.

Sincerely,

Joe Smith

See the following page for an example of a Limited Power of Attorney form.

**Partner with the Seller for High-End or Hot Markets**

There are some states and locations where property values are very high and might be cost prohibitive or risky. Consider partnering on those homes with the seller, making the seller a partner in the profit of the sale. If a home is worth $700,000 and the rental rate is $3,000 per month, you may feel hesitant to take on this type of property; however, this home may also net $150,000 or more in profit. A seller of this home may also feel uncomfortable giving away all the profit for this type of property. This might become an objection for a seller in this price range or in a hot market that is appreciating rapidly. You can always offer to partner with this type of seller. A partnership doesn't have to be 50/50, but it can be. If you are doing all the work, the partner should cover all the risks. For instance, if the home is vacant, the seller should continue to cover the monthly mortgage payment, or if the tenant-buyer doesn't pay their rent, then the seller should cover the payment. If they want part of the reward, they need to cover the risk.
STEP FOR BUYING PROPERTIES

Limited Power of Attorney

This limited Power of Attorney is given to _________________, for the purpose of Closing, Closing Documents, Contract Changes that don’t affect owner’s bottom line, Insurance, Mortgage Payments, etc., or any other matters that pertain to the property located at:

___________________________________________________________________

This limited Power of Attorney shall become valid as of the date signed below and be in force until the final closing of the property. Photocopies of this document shall hereby be treated as original counterparts.

POWER OF ATTORNEY GIVEN TO: _________________

Agreed to by:

_________________________________ _____________________________
Seller’s Name Seller’s Name

_________________________________ _____________________________
Date Date

Notary

STATE OF ____________________ COUNTY OF _________________________

Before me personally appeared _____________ ______________________, to me well known and known to me to be the person described in and who executed the foregoing instrument, and acknowledged to and before me that he executed said instrument for the purposes therein expressed.WITNESS my hand and official seal in the State and County aforesaid, this __________ day of ____________________ 20XX.

___________________________________________
Notary Public Signed

____________________ _____________________
My County of Residence My Commission Expires
Advanced Concepts and Strategies

Refinance for Cash

Refinancing may not seem like an advanced strategy, but you can make it into a very lucrative tax-deferred strategy. For example, let’s say you have a house that’s worth $200,000 and you only owe $140,000 on it. You can refinance it (i.e., a new mortgage) and take out some of your $60,000 in equity, which is not a taxable event. Now you have a portion of that $60,000 to reinvest while still holding on to the original property. Talk to a mortgage broker in your area for current programs and your individual situation; most likely you will not be able to take out the entire $60,000, but each case is different.

Lease options and subject-tos are investment strategies that can take nontraditional forms.

Ethics and Capital Gains

There are ethics issues you will need to deal with in the real estate investing business. Many times we as investors will know about certain IRS or other regulations or laws relating to real estate that the seller may not understand or even consider when making a deal with us. It is important to deal with everyone fairly. The IRS rules are constantly changing and you can’t give tax advice unless you are a CPA, so have the seller check with their CPA or tax adviser, but you should be aware of the capital gains rules and how they can affect your sellers.

The Capital Gains Rule

If you have lived in a property as your primary residence for more than two years and you sell it, you don’t have to pay capital gains. The IRS has changed the capital gains on our personal residences to a rule that, in simplified terms, goes like this: Every two years you can sell your primary residence (yes, the one you live in, not your investment deals) and you can keep the profits of up to $250,000 if you are single and $500,000 if you are married, tax-free. Anything above that is taxable, and any time period different than that becomes more complex. Basically, if the seller lives in it for two out of five years, it qualifies for this tax-free gain. This allows the seller to rent the home for three years—but not one day longer. This rule may also change.
However, if I know the seller has little to no gain in the home, I am far less concerned about their capital gains and may do a five-year option.

**What to Do When Your Option Comes to an End**

Time is running out on your contract—now what? Let’s assume you had three years with the seller to purchase their home. The time is fast approaching and you do not have a buyer who can purchase yet. First, make sure you don’t end a contract with a potential buyer on the same day that your contract ends with the seller. I recommended...
leaving three to six months at the back end of a deal. For instance, if you have three years with the seller, you should give your buyer 12 to 18 months. If they don't exercise, then give the next tenant-buyer only 12 months, thereby leaving yourself six months at the end of your contract with the seller for other possibilities.

Let’s say buyer number two doesn’t want to exercise either. What are your choices? Surprisingly, there are many—I’ll name six here. You can do any of the following, and in any order you choose, but I recommend that you always try number 1 first:

1. **Ask the seller for an extension if you want one.** Most sellers will give you an extension if you ask. Many times the sellers will just give it to you with no costs. Sometimes the extension might cost you more money—a little more now in the form of an option fee, in the future on the sales price, or more each month. If you can work it out for a win-win, do it. Make sure the extension is in writing—don’t take their word for it. All real estate contracts *must* be in writing or they are not enforceable.

2. **Buy it yourself.** You can get a mortgage with a lender and purchase the home. You would definitely want to consider this if you can afford to do it and there is enough profit in the deal. Don’t give the home back to the seller unless it is not worth the amount you agreed on or there is something wrong with the market or the home (something that you or your tenant didn’t create). With 12 months of canceled checks on a lease option, you can get a mortgage that is treated like a refinance rather than a purchase. This type of program is also available to your buyers after 12 months of payments. If your mortgage broker doesn’t have this program, find another mortgage broker. You don’t always need good credit yourself if there is enough equity in the home. Look around and talk to some lenders, but don’t wait until 30 days before the end of your contract—talk to a mortgage broker months in advance. Sometimes these types of loans can take months—I found this out the hard way.

3. **Sell the home directly to another buyer.** You will have to sell the home to another buyer directly, not a tenant-buyer. It may be someone referred by a Realtor or someone you found in the newspaper.
4. **Partner with someone if you can't do the mortgage yourself.** If the home has some equity and you can't refinance it, you can't sell it, and the seller won't extend, then bring in a money partner who can get the mortgage. Give them a part of the equity or a fixed amount for doing the financing. This will give you more time to resell it on the market or to lease option it again. You can find money partners in your local real estate investing group.

5. **Don't exercise your option.** Tell the seller you don't want to purchase, and then you can walk away from the deal. Remember that an option with the seller only gives you the right, not the obligation, to purchase. You must return the home in equal or better condition, less any normal wear and tear. You can't return the home with damage.

6. **Assign the deal to another investor.** You can wholesale this lease option to another investor for a fee, and then they can do one of the above five choices.
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS
CHAPTER 10

Building Rapport and Sharing Lease Options with Realtors

Why Work with Realtors?

Approximately 80 to 90 percent of the nice homes on the market are listed with Realtors. The percentage varies from city to city and area to area, but they certainly control most of what’s on the market. So they have access to the sellers that I need to get to in order to buy those homes. They will not participate in subject-to deals, because of the risk to their sellers, so I will not talk about that acquisition technique in these next two chapters on dealing with Realtors.

Working with Realtors will change your investment strategy forever. Thanks to Realtors, I get more deal offers than I can go look at—I don’t chase them anymore. Once you get the Realtor system working for you, you will only need to evaluate which deals you want to pursue. The Realtor system is getting Realtors bringing you deals.

Many investors believe that real estate agents don’t have the best deals, or that the deals have already been picked over by the time they actually hit the market. In many cases, this is true—there are deals that never hit the market, because they are very good. Realtors have clients who buy the best deals before they ever list them on the MLS (Multiple Listing Service). There are also deals that never
get to a Realtor—foreclosures, traditional for sale by owners, the homes investors find by driving by, and so forth. But I believe some of the sweetest deals are sitting on the market, listed with a Realtor, deals that no one even sees because they are looking for traditional or wholesale types of investment homes (meaning paying cash or getting a mortgage on the home) and not lease option homes.

When an investor considers traditional financing or buying with cash, they must be able to purchase the home for a much lower price. However, when they can buy the home on a lease option (terms) then they can pay a higher price, therefore opening up the market to more properties to choose from. When working with Realtors, it is less possible to lowball a home and get the deal through. Realtors typically don’t like investors for that reason.

Since most of my lease option deals come from Realtors, it is important that I understand their perspective. Most of them have been trained to sell real estate for a living—traditionally, from beginning to end—in these ways:

**Six Steps a Realtor Goes Through on a Traditional Sale**

1. List a home for sale.
2. Find a buyer.
3. Get a contract signed.
4. Have the buyer get a mortgage.
5. Close on the home.
6. Get the commission.

Most Realtor deals are done this way, but what about the times when their listings don’t sell? or when they don’t sell quickly enough for the seller to feel comfortable? They are not taught to bring creative alternatives to the table for their sellers.

In a strong seller’s market, Realtors typically don’t need to consider anything creative, because homes are selling very quickly. However, even in seller’s markets there are some homes that won’t sell quickly for some reason. These are the homes that Realtors will need to consider being creative with.

In a buyer’s market it is much easier to pursue lease options with Realtors and sellers. They will be more creative and open on
ways to sell their listings. In a buyer’s market the Realtors won’t get any commission if the home doesn’t sell or if the listing expires and the seller lists the home with another Realtor. Also, in a buyer’s market, sellers tend to put more pressure on their Realtors to sell their home, which pushes the Realtor to be more open-minded to new ideas and to pursue other alternatives for their sellers. They really do want to sell their customers’ homes, to help both their sellers and their own business. That’s where I come in. I teach Realtors about the alternatives I offer and how I can help them help their seller.

Finding the Right Realtor

The Realtor you will need to find for lease options will be a seller’s agent or what is called a listing agent, the one that lists the home for a seller. A listing agent is the one who works with the seller and has his or her name on a sign in the seller’s yard. If you want to buy in a certain neighborhood, you can usually find the strong listing agents by driving through and seeing whose names appear on the real estate signs in the yards.

A buyer’s agent, on the other hand, represents and works for the buyer. A buyer’s agent looks out for the best interests of the buyer whereas a seller’s agent (listing agent) looks out for the best interests of the seller. You want a buyer’s agent when you’re purchasing your own home, but a listing agent is the one to work with when buying lease options or lease purchases—with my strategy.

Realtors have a relationship with their seller that is very unique. Sellers tell their Realtors almost everything about their personal lives. Realtors therefore know who is motivated and why. They know who is getting divorced, if they are in trouble financially, if their builder is almost done with their new home, if they have custody issues, if they are getting worried about double house payments, and how many grandchildren they have—as well as the name of their dog who died last year and what Uncle Ned did at the family reunion. I imagine Realtors sometimes want to say, “That’s really more about your personal life than I ever wanted to know,” but they don’t. They stay as interested as possible in order to build rapport.

Because the Realtor is providing a very necessary service to the
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

homeowner in helping them sell their house, and because the homeowner so freely tells the agent *everything*, the homeowner is not shy about calling the Realtor and saying the four-letter word after the home has been sitting on the market awhile: “Realtor, if you don’t sell my home soon, I am going to have to *rent* it!” This word makes a Realtor cringe. The only thing you can say to a Realtor that’s worse is, “Take my home off the market.” If the home doesn’t sell soon, the Realtor won’t get any commission and has lost countless hours in showing the home as well as dollars in advertising and marketing. Although the Realtor is licensed to rent it for the seller, most Realtors don’t know how or don’t want to rent it. The commission for renting a home is so small, it is generally not worth their time, unless they are a property management company and do a large volume of rentals. Many real estate companies don’t handle rental properties at all because it is a such a different type of business and carries one of the biggest liabilities for Realtors.

In my area, when a Realtor hears the four-letter word *rent*, my phone rings. I have spent years developing rapport with the many real estate offices in my area as well as with individual Realtors. They know what I am looking for, and they know how to pique my interest in ways that might get me to drive by the house and see if I’m interested. Why? Because when they work with me to give me leads on potential lease options, they know they can get their commission paid—and paid much more quickly than on a traditional rental deal. Although I don’t pay it myself, technically—the seller always pays that—I am willing to front the commission. This creates a win-win-win between the Realtor, seller, and myself: The Realtor sells the listing, the seller sells their home, and I buy another investment home. We all win!

Networking with Realtors

You only need to work with two to four listing agents per year to make a comfortable living. You can find listing agents in the real estate section of your newspaper or through personal contacts or your investor groups. I have one Realtor in my area who gives me only one deal a year, but I make at least $30,000 each time. I stay in touch with
Building Rapport and Sharing Lease Options with Realtors

her every few months just to keep my name fresh and to keep the relationship moving forward.

Realtors know lots of other Realtors, so if you have one contact, you can network through that one to access many others. Call the local real estate board to find out when they have local functions, and go mingle. Exchange business cards at the functions. If you don’t have cards, get some printed. It’s more important at this point for you to have their cards than for them to have yours, but having a card to exchange is more professional. You want them to know who you are and how to get in contact with you. Take a Realtor out to lunch.

Rent a conference room and invite Realtors to a wine and cheese party; then give them a presentation about lease options or lease purchases. Draw them in by focusing on what’s important to them: “Would you like to sell more listings and make more money this year? I can teach you for free!” Do something to advertise it that grabs their attention without giving away all the details. Don’t be alarmed if only five or six people show up, because those few are very interested in creative solutions. You might even put on your invitations: “Would you like to be more creative than your competition? Would you like to know things that your competition doesn’t know about yet? I can teach you some creative ways to sell your listings that your competition hasn’t even thought of.”

If you are not sure who to call to get started, talk to the people in your local investing group, since there will be some Realtors in your group. These are not the Realtors you will be working with, as these are investors themselves and not traditional listing agents, but they should be able to tell you who the listing agents are in their offices. The top listing agents from the companies are also listed in the paper. It’s worth starting a database or spreadsheet to keep up with who is where and what they do, especially with the people you begin to contact and develop relationships with.

Your local investors group can also be a great resource for brainstorming more ideas on drawing people in. Not only will they be interested in giving you feedback, but you may even find a money or managing partner there who is also keen on investing in the lease option strategy. You can then go in as a team and make a presentation.
Sharing the Realtor System and Targeting Realtors

Working the Realtor system is a multistep process. Building a relationship with a Realtor does not happen overnight. Just as you need to build rapport with your sellers, you also need to build rapport and credibility with Realtors. Here are some tools to get the process moving forward.

**Letters**

I have a couple of letters that I use to contact Realtors, primarily those with homes that have been listed over 90 days on the market. One letter is for use during a buyer’s market (lease options) and the other for use during a seller’s market (lease purchase). They both explain when a Realtor should consider me and how lease options and lease purchases can help them and their sellers. It is very important that a Realtor understands how you will help their seller. Their first obligation, by contract, is to the seller. Then they are concerned about themselves. My letter explains how I will help their seller and pay them.

**Phone Calls**

I will also call Realtors and go over something similar to what my letter says. You might want to catch them after hours so you can get your entire thoughts out on their voice mail and not flub it up, or if your time is limited. Then they can listen to it more than once and call you back for any questions. Also, it doesn’t tie you up in a 30-minute call where there may be no interest.

Basically my message will sound something like this:

> Hi Sally, this is Wendy Patton. I am calling about your listing on 123 XYZ Street. I am wondering if it is still available? I noticed it has been on the market for a while and I wonder if your sellers would consider something a little creative? Something like a lease option? If your sellers don’t need their cash out now but would like their monthly pay-
Building Rapport and Sharing Lease Options with Realtors

ment made and you would like to sell their home, and get paid your full commission, please give me a call. Sally, if it won’t work for this seller, but if any of your other sellers have said to you that if their home doesn’t sell soon, they might have to consider renting it, please give me a call. I buy homes when sellers can consider terms like this. Don’t lose your commission to sellers that want to rent. Please call me. Thanks, Sally, for considering this. My number is . . . Again, my number is . . . and my name is Wendy Patton. Thanks, Sally.

This might be what I would say in a buyer’s market. If it was a seller’s market I might change the wording to a lease purchase. I would add that it’s a guaranteed sell for the seller and that the Realtor’s commission is paid up front. This makes it a much stronger call, which is necessary in that market. See Chapter 11 for the letter I use in the seller’s market, with wording that makes it appealing to the Realtor.

Getting Your Foot in the Real Estate Office Door

Real estate offices get many requests to host speakers and salespeople, so it can be hard to get an appointment. The best way to start is to go to a real estate office where they know you and can recommend you. If you know someone who is a Realtor, ask them if they can assist you in getting into their company meeting agenda so that you can do your presentation. If you don’t have a contact, then call the office directly and speak to the office manager or broker, and use an introductory letter. Tell them a little about yourself, keep it brief, and ask if you can present your ideas to their staff. They get bombarded daily by mortgage companies, title companies, and many others trying to get their business, so they don’t like a lot of salespeople and they like to keep it short and sweet. However, keep in mind that the lease option or lease purchase system offers something unique and different. The real key is to show them how this system will help them to sell more of their listings.

I like to send a letter to the broker that grabs their attention. That means I leave out stuff about me, my background, and my
credentials, because when it comes down to it, I’m trying to sell a con-
cept more than I’m trying to sell me.

Your letter should be on letterhead and might sound something like this:

Dear (broker’s name),

Would you like to assist your agents in learning new ways to sell their listings? I buy real estate and I have some ideas for your agents on how to sell more of their listings. I buy many homes in this area. I have a professional presentation that I would like to show you and your agents. I understand you get bombarded with salespeople trying to speak to your agents. I am not a salesperson. What I offer is unique and is something every real estate agent should know about.

I have some creative ideas that might help you sell some of your office listings. I don’t sell anything. I would love to meet with you to explain some of my ideas. My presentation is 10 to 15 minutes, so it will not take up much time, but it will be very valuable for your agents and your company.

We have many references from clients like yours and from other real estate agents, including (agent 1, agent 2, agent 3). Please talk to them to find out how easy it is to sell a home to (your company name). Please call me to set up a time when I can meet with you and share the information that I would like to present to your real estate agents. My phone number is (222) 333-2222.

Sincerely,
Wendy Patton

I also have letters that target specific Realtors and their listings, and I send them out constantly.

Educating Realtors

Realtors are not trained to do creative selling, and sometimes investors think they are not very sharp because they don’t know how to do unique deals. That’s one of the biggest stumbling blocks for in-
Building Rapport and Sharing Lease Options with Realtors

vestors trying to work creatively and effectively with Realtors—investors expect something that Realtors are not trained to do. As an investor, you will need to instruct a Realtor if you want them to be able to work effectively with you. This doesn't mean teaching them how to invest, but what key words they should listen for and how it will help their seller and themselves.

When people get real estate licenses, they are trained mostly on the law—seller contracts, lead-based paint, legal issues, fair housing, and things that are required by the state to make a real estate transaction go professionally from start to finish. However, they are not taught things like, “What if the house doesn’t sell?” or, “What if the seller says that four-letter word?” It is your job to teach a Realtor what to listen for and how to help you and themselves in these types of deals.

Most of us know at least one Realtor, or we know someone who knows a Realtor. Practice your presentation on lease options or lease purchases with a Realtor, and ask for feedback: “Did I present the lease option concept clearly?” “Was my presentation too long? too short?” “Is there a better way for me to communicate this idea to Realtors?” “May I set up an appointment to present this at your local office?” The last question is especially good if your practice presentation has gone well and you are ready for the next step.

You will then want to go to the Realtor’s office meeting. Call their broker or have the Realtor set it up for you to come to one of their meetings.

What to Bring to a Meeting

You must have a presentation prepared before going into a meeting. Don’t ever think that you know enough to just wing it. Here’s a list of what to bring:

- When you attend a meeting, it is customary to bring donuts or bagels, so call first and ask the office manager or broker what the agents would like.
- Have all your materials organized neatly and accessibly. You don’t want to be fumbling for information and making them wait on you. Time is money—they will want you to be in and out quickly.
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

- Enough handouts of your presentation for everyone who attends the meeting and for the absentee agents. Call first and get a head count. Always have more than necessary in case they ask for extra copies. You won’t need to give them a copy of each slide you present, but you can give them a one-page overview of how lease options will help them and their clients.

- Extra business cards (stapled to your handout).

- Make sure all handouts have your name and contact number on them.

Begin Your Presentation

Realtors will be open to the idea of lease options, or lease purchases, if you help them understand how they work and when they are appropriate for their sellers. Lease options are not the right thing for all sellers. The presentation needs to be educational about the benefits of lease options to them and to their sellers. I give a PowerPoint presentation going over the program step by step, and then open it up for questions and answers afterwards. If you don’t have a computer to bring with a PowerPoint presentation, you can make overhead slides.

Your presentation might start off something like this: “Thank you for allowing me to come to your meeting today.” Always remember to thank them for their time. “I am here to talk to you about some very exciting concepts that I have discovered that work for Realtors and their clients. Specifically, creative options for Realtors—things that you may not have thought about before or may not have considered for your clients. Let’s get started.”

Here is an outline of what I cover in my 10-minute presentation.

1. Introduction of myself and the name of my company.

2. My agenda: Discuss creative and innovative options for Realtors.
   a. Why I’m not a competitor but a help.
   b. How to help them sell their listings.
   c. Unconventional versus traditional sales approaches.

3. What to look for in a seller who might need my services.
Building Rapport and Sharing Lease Options with Realtors

4. What to look for in a buyer whom the Realtors can’t help.
5. The lease purchase or lease option—when I do it and the guarantee it brings.
a. How it works.
b. How I pay commissions.
c. Benefits to the seller:
   - I take over payments.
   - I take over maintenance.
   - No rental headaches.
d. Benefits to the listing agent:
   - Quick sale—saves time and money.
   - Commission paid up front.
6. What types of homes are acceptable to me.
7. What price range I’ll consider.
8. Referral fees.
9. Closing statements.
10. Ask if they have any questions.

I don’t stay very long once I’m done. Usually the questions are brief, and I’ll stay only as long as they continue to ask for more information. But Realtors generally don’t have a lot of free time in the office, so they’re looking to get as much information from me in as short a time as possible. Many times, after my presentation, they realize how I can help their sellers. Then they start to write down addresses on the back of their business cards for me. I often walk out of presentations with lots of cards and leads to pursue.

Making the Realtor Part of Your Team

If you’re new at this business you might feel like a very little fish in a big pond, but when you have established a relationship with a Realtor, they become a part of your team whether they realize it or not. Now you’re going to start to work together on finding solutions for the rent problem. You will also be able to help them during a buyer’s
market when things are slow by cherry-picking their motivated seller deals as investments.

Because they are a part of your team, you will want to build that relationship above and beyond just what they can do for you and what you can do for them. How about sending a thank-you gift every time a deal goes through that they have led you to? These little rewards go a long way in keeping the rapport top-notch and ensuring even more leads in the future!

Building Rapport: The Follow-Up

Follow up monthly with Realtors who might be strong listing agents or who work with lots of sellers. Remind them what you are looking for. Remember, if they are successful they are busy, and they might not always remember you. You might have to remind them of what you do and how you can help them in their business.

I don’t like to call Realtors during the day and interrupt them—or interrupt my own day. I prefer to call their offices late at night and leave a voice message. That way they can listen to it first thing in the morning—they start their day off with me reminding them of a creative way to do business. It might sound something like this:

*Hi Kathleen, this is Wendy Patton. I wanted to say hi and let you know I’m looking for another home that I can buy on a lease purchase. Do you have any sellers right now that might be able to consider this type of solution? If so, please give me a call. My number is __________. Thank you, Kathleen, and I hope to talk to you soon.*

If I haven’t done business with them yet but I have been trying to start the relationship with the first deal, I would say something else:

*Hi Kathleen, this is Wendy Patton. I am still looking for a home and I was wondering if any of your sellers have said that they might consider renting their homes if their home doesn’t sell soon? I know most of your sellers do want to sell their home outright, but if you do ever hear one of your sellers say they might rent it, Kathleen, please do call me. I will make sure you get your commission in full.*
Building Rapport and Sharing Lease Options with Realtors

If you aren’t a licensed Realtor, you can add:

Also, Kathleen, you will get to double-dip on the commission and receive the full buyer agent portion, too, when it closes on the back end. I don’t have a Realtor involved. I will write up the offer, but you can have the entire commission. If your sellers rent out their home, they might not sell it, and neither one of you would really get what you want. I would love to do a lease with an option and make sure you both get paid in full. Please keep me in mind if this type of situation comes up. This usually works well for any type of seller that does not need their cash out at closing to move on to their next home. Thanks so much, Kathleen. Feel free to call me with any questions. My number is. . . . Again, that is. . . .

Follow-up is key with Realtors. However, don’t be a pest. I would recommend a reminder call no more than once a month, maybe even every other month, especially after you have the relationship established. And you don’t want to say the same thing each time you call. Try another way to explain how options or creative deals work. Here’s another example:

Hi Kathleen, this is Wendy Patton. Just checking in to see if you have any sellers who might not need their cash out of their home at closing or who might be financed near 100 percent? If so, my type of solution might work well for them. Give me a call on any listings you have like that so I can set up a time to go and see them. I hope to talk to you soon on one of your listings. Kathleen, thanks for the opportunity to work with you. My number is. . . .

Wendy’s Advice

Get the Realtor system shared with some Realtors. The sooner you do this, the sooner you will get Realtors begging you to buy their listings!
Ethics with Realtors

Honesty and integrity with Realtors will be the key to successful relationships with them. If I deal badly with Realtors, it’s going to affect my reputation and damage the business for other investors. Real estate is a small world, and word gets around if you stiff a seller or walk away from a contract and tell them, “Go ahead and sue me.” Realtors find out, and, as previously mentioned, they control 80 to 90 percent of the homes on the market. Even if your own ethics are good, if Realtors hear horror stories about deals gone bad because of investors who reneged on their lease options or lease purchases, it hurts the market for the rest of us.

If you’ve committed to something with a Realtor, get back with them and do it. There’s nothing worse than going to a group of Realtors with a presentation, getting 10 leads, and then never getting back to them regarding what happened with those leads. The Realtors will wonder what the point of helping you with leads is if you don’t follow up. It’s the surest way to kill the rapport you have worked to establish. Did you look at the properties? What did you think? Are you interested? Are you going to pursue? Follow up and let the Realtors know! Even if you don’t have time to look at the properties, or they weren’t what you wanted, communicate that. Keep the lines of communication open so they will continue to provide you with leads. The relationship must be a two-way street. And the more you give, the more they are willing to give.

Sometimes a Realtor will call me about what I call a dumpy property. I look at it and know it is overpriced. Now I’m faced with a dilemma: I don’t want to insult the Realtor, because I want to keep that relationship positive, however, they were the ones who called me about the property. The best strategy is to be honest with them. I would say something like this:

*Sally, I looked at the home on 123 Main Street today. Boy, with what it needs, and what I think I can sell it for, and my carrying costs, the most I could offer would probably be an insult to the seller. I certainly don’t want to affect your relationship with the seller. I think I will have to pass on this one, unless you want me to still write it up. I will leave this up to you.*
See how I keep the door open to them? I explained my reasons in terms that the Realtor can understand without being insulting to her or the property. Not only that, but I’ve left the lines of communication open in such a way that the Realtor will call me back one way or another regarding the house. This is what I want: I want them to continue to call me because they are my first relationship. Forget the house! Many times they know it is overpriced and they just want an offer to show the seller. If they want me to write up an offer, I will. What often happens in this case is that the seller doesn’t think their home is overpriced until they get an offer from me and are shocked into reality. Then the seller reduces the price and the agent can finally sell the home. Thus, I have helped the Realtor make the sale. This might not help me as an investor today, but it will help me when the Realtor thinks of me for their next listing. For me, that one home is just a home. I want the relationship, so that they will bring me five more homes down the road.

Remember that being an investor is a long-term strategy. Building rapport with Realtors is an essential part of the long-term big picture.
Why Aren’t Lease Options or Lease Purchases Appealing to Realtors?

When I first started doing lease options with Realtors back in the early 1990s, it was a strong market in Detroit, but I wasn’t getting very many leads. This both puzzled and bothered me because I thought I had something great to offer them. I went to my best friend, Debbie, who is and was a local Realtor. I said, “Deb, look what I’m offering these Realtors—it’s a great thing for their sellers! Why aren’t they all coming to me with their deals?”

She looked at me and said, “Wendy, do you truly believe it’s a great deal for the Realtors if they have to wait three to five years for their commission? They might not even be with the same real estate company when the house closes. This is a hot market—they can probably sell their listings to someone else and get paid before then. They’re not motivated to work with you on these types of deals. Why should they wait for years for their commission when if they just wait for a couple more months, possibly weeks, on the MLS, they’ll get their full commission now?”

I replied, “So what should I do?”
She said, “You’re creative. Think of something.”
I said, “You mean like pay their commission up front?”
She responded, “That would be a really good start.”
And that’s when I started paying Realtors their commissions up front, and my ability to purchase completely turned around, especially in a seller’s market.

Addressing the Commission Issue

Realtors are not greedy, but they do want to be paid for the services they are providing for their sellers.

By contract, they are not entitled to their commission until the sale closes. If closing is a number of years down the road, what’s the likelihood that the Realtor will want to wait that long? They may not even be with the same real estate company by then, and because the deal is with the company, not with the Realtor, in most states if a Realtor leaves one agency and goes to another, they may completely forfeit their commissions. This makes the option strategy unappealing for Realtors, primarily in a hot market.

The Realtor’s job is to look out for their sellers’ best interests, and many Realtors don’t feel a lease option is a good solution for the sellers. If a Realtor is simply dead set against it, just move on. There are lots of Realtors who are creative enough to want to work on finding innovative solutions for their clients. You just have to help them understand when these solutions would apply. Likewise, if a seller adamantly won’t do it, move on. Only spend your time on the people/sellers open to the idea.

The reason most Realtors don’t consider these creative solutions and can’t help their sellers move in that direction is because most sellers can’t consider a lease option or purchase. Most sellers need their cash out in order to buy the next home. I estimate that only 5 to 10 percent of sellers can consider a lease option because these sellers don’t need their equity out of their home to buy their next home. In my experience, sellers who can consider a lease option or lease purchase will usually do it for two to five years in a seller’s market and three to ten years in a buyer’s market. The seller’s situation will determine the length of the lease option, the payments, price, and other terms.
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

When a lease option is a viable solution for a seller, the next hurdle is to ensure that their Realtor will benefit from the deal as well. This chapter explains how to keep the Realtor in the win-win formula, and how to keep that positive rapport with the Realtor for future deals.

In a seller’s market, my letter to the Realtor would look like this:

Dear Sally,

Would you like to sell your listing at (address of property)?

Maybe we can help. We buy homes . . . especially when your clients can accept terms like a lease purchase. As soon as your client says to you, “If my house doesn’t sell soon, I might have to rent or lease it,” this is a great indication that our services might help you sell the listing.

When your client sells their home to (your company name) . . .

YOUR COMMISSION IS PAID UP FRONT!
and it would be a guaranteed closing for your seller.

When would a client be able to accept a lease purchase?

Here are some situations:

1. They don’t need their cash out yet but would like to either have cash flow or have their payment made.

2. They have very little equity (i.e., financed near 100 percent).

We have many references from clients like yours and from other real estate agents, including (agent 1, agent 2, agent 3). Please talk to them to find out how easy it is to sell a home to (your company name). Give us a call if this type of solution might work for your client.

Sincerely,
Wendy Patton

In a buyer’s market I would use the words “lease option” and I would also say their commission is paid “in full” versus “up front.” It is not as strong, but still very positive.

After I started to send out this type of letter, the deals started to
come in. The commission was no longer a stumbling block issue for the Realtors—they didn’t have to worry about waiting for years to be paid for the work they were doing then.

In a weaker market or a buyer’s market, I don’t pay the entire commission up front—I might only pay part of it, say 1 to 1.5 percent versus the 3 percent I would pay in a seller’s market. They would then have to wait until closing for the remainder of their commission. In a weaker market they realize that they might not get paid at all if their listing doesn’t sell. At the same time, I am getting less from my buyers in these markets. Remember, a slower market for sellers means a slower market for buyers; less money for sellers translates to less money for buyers. Realtors understand that when business is slow for them, it is slow for me, also.

Here’s an example: I offer $200,000 in a seller’s market and I pay 3 percent of the listing portion of the commission up front. This is $6,000. I would owe $194,000 when I pay off the seller (when I exercise my option). However, if I don’t exercise my option, I would not get that money back. I am fronting the seller’s expense for the real estate commission.

Structuring the Deal for the Realtor

Understanding the current economy is essential for making the offer work effectively. Know whether you are in a strong buyer’s market or seller’s market so that you can structure your offer appropriately.

Seller’s Market

This is the market where things are selling quickly, appreciating strongly, and sometimes multiple offers are made on the same house on the same day. This is also a time when the economy is good, things are happening, there’s a lot of new construction, and so on. When homes are selling quickly, Realtors are getting paid quickly and in full, so in the beginning of a lease purchase, I offer to front their commission in full. Realtors prefer a lease purchase in
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

a strong seller’s market. A lease purchase means you are guaranteeing you will buy that home, so don’t do it unless it’s a strong seller’s market, with good appreciation, or you’re positive you want that home.

Buyer’s Market

A strong buyer’s market is the opposite: Things are not selling, business is slow, unemployment is higher, homes are sitting and sometimes going from one Realtor to another in an attempt to sell, and there’s little or no appreciation, sometimes even some depreciation. Net result: Realtors are not selling their listings. The result is Realtors are much more negotiable because they’re likely to lose their listings, and the sellers know that things are slow, which is making them more anxious. This opens up many opportunities for lease options. During this time I only offer part of the commission up front, possibly part in 12 to 18 months, and the rest at closing. Keep in mind, however, the fee is really coming out of the option fees that the tenant-buyer pays to me and not out of my own pocket. When I assist the Realtor in getting paid, they are more likely to work with me again. The rule of thumb is: Weak market, weak offer; strong market, strong offer; but above all, always be fair.

Sequence of Events When Working with a Realtor

The Realtor gets paid when I put someone in the home—in other words, when I get money from someone else. The sequence of events is as follows:

1. The Realtor gets a listing.
2. The seller says the four-letter word, “rent,” and the Realtor shares it with me.
3. I look at the property.
4. We negotiate it through a proposal.
5. We agree on the terms.
6. I write up a full offer.
Closing Deals with Realtors

7. The offer gets signed.
8. I find a tenant-buyer.
9. I pay the commission or a portion of the commission to the Realtor.
10. The tenant-buyer moves in.
11. Closing happens at a later date.

Sometimes I say, "I'll commit but not until . . ." and I give them a future date because I need time to find a tenant. Even if my tenant doesn't move in by the start date, I am still responsible for paying the full commission on that date. It is a stronger offer to a Realtor and to the seller if you commit to starting on a certain date, regardless of whether you have a tenant. If there is no tenant-buyer, the commission will come out of your pocket—not exactly zero down for you the investor, but it is still a low down payment on the deal. If you have a tenant-buyer, the commission you need to pay will come out of the option fees from your tenant-buyer. You'll have to decide what risk you can afford when you set the start date.

If a Realtor is working with a non-Realtor on a sale, the Realtor will be glad to wait for half of the commission up front, but they won't wait for all of it on the back end. They'll wait for a double dip, however. A double dip is when the Realtor gets the portion from both the seller and the buyer. If you are not licensed, the Realtor would get both sides of the deal. (I need to be very clear about the payment to Realtors. It isn't the Realtor I pay but the brokerage firm the Realtor works for. The Realtor gets their commission cut through the brokerage.)

Structuring the Deals—the Details

A proposal is used to put together a mock-up offer to a Realtor that they can then present to the home owner or seller. It will put down the overall terms in writing without the specifics. This saves a lot of paperwork because you only fill out the entire offer after you have an agreement on the proposal.

Here is what a proposal can look like to a Realtor or a seller. This is a lease purchase example, but it could be modified in format for a subject-to or lease option.
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

Majestic Realty, LLC

Proposal

123 XYZ Street

Innovative Approaches to Leasing/Selling

Majestic Realty, LLC
has 2 programs to offer you...
Closing Deals with Realtors

Please review the following options that we can offer you as a seller and consider which would serve you best!

Lease/Purchase to Majestic Realty #1
Majestic Realty can guarantee you a monthly fee of $1,100.00 for a lease term of 3 years. We would then guarantee the purchase of your home within the 3-year term at a price of $250,000.00.

Lease Purchase to Majestic Realty #2
Majestic Realty can guarantee you a monthly fee of $1,150.00 for a lease term of 5 years. We would then guarantee the purchase of your home within the 5-year term at a price of $255,900.00.

In options 1 and 2 we would pay the rental amount whether the home is vacant or rented. You would still need to carry your homeowner’s insurance and pay your property taxes until the home is closed. We would be responsible for everything else from the date this agreement starts, including all maintenance (minor and major, except the first 60 days). We will do a home inspection prior to taking over the lease purchase agreement. We would like to have all the appliances left with the home. This would not be a VA or FHA type financing, and you would be responsible for nothing when we get our mortgage. You would pay only the seller’s title insurance and transfer fees.

We will start this contract when we find someone to lease from us; however, in the meantime the seller has the right to leave the home on the market. If you sell the home first, then this offer would be declared null and void.

The purchaser will put $7,500 (3 percent) down, which will be paid directly to (realty company name) and applied toward the listing portion of the commission and the purchase price at closing. Any remaining commission due will be paid out of the seller’s proceeds at closing, to (realty company name) and Majestic Realty, LLC.

We have many references available upon request. Thank you for considering Majestic Realty!
HOW TO GET REALTORS TO HELP YOU DO LEASE OPTIONS

Don’t be anxious on the proposals—make it low pressure. When you’re first starting out, you’ll want more deals to go through because there’s a great excitement in the newness of the game. You’ll be revisiting your proposals, wanting a quick response, and thinking of ways to use the money you’re going to get on the back end if everything goes as expected. Although I do try to come up with creative solutions if I think there’s a profit to be made, I don’t keep checking my proposals. It’s a bit like testing the doneness of spaghetti: You throw it against the wall, and if it sticks, it’s done. If your deals stick, they’re done. If they don’t stick, hopefully you’ve got others in your hip pocket that you’re working on anyway. Don’t get too wrapped up in a deal happening, because a lot of them won’t. About 30 percent of my proposals work out—which means that 70 percent come up empty.

With some of the Realtors I know very well, I might even do a verbal proposal. For example, I might say, “See if the seller will go for $1,200 per month, and if they do, then I’ll put together a proposal.” I’m just fishing a little bit to see if it’s even worth sticking around in that spot or moving to another. If the seller goes for it, I hammer out a proposal, and if not, there are plenty of other deals out there!

Wendy’s Advice

If it is meant to be, it will be.
PART 4

STEPS TO SELLING PROPERTIES ON LEASE OPTIONS
CHAPTER 12

Finding and Qualifying a Good Tenant-Buyer

Understanding how to screen and select tenant-buyers is the key not only to being a good landlord, but also to the business of selling and using the lease option technique.

A Story About Working with Buyers

A strange thing about prospective tenant-buyers is that you can’t always tell who is going to exercise by how well things are going with their tenancy. Some people struggle to pay their rent but end up getting a mortgage on your home, and others pay perfectly and don’t end up buying.

I had perfect tenants in an 18-month lease option and everything was going so smoothly I was sure that they were going to exercise the option. Then in month 17, I received a call from the woman, who was crying. She said, “We have a problem. I can’t pay my rent next month.”

She was sobbing. She and her husband were getting a divorce and she didn’t have the money for the rent. She was very embarrassed and wanted to work things out in any way possible. Thinking she
wouldn't be able to stay, I asked if it would be possible to start showing the house right away, and she said, “No problem. By the way, I do have some jewelry. Would you take that in exchange for my rent?”

My ears perked up. “What kind?” I do like jewelry, but really I was thinking, I might not ever get paid this rent, so maybe I might should consider accepting the jewelry.

The woman answered, “Diamonds and emeralds.”

I said, “Really? When can I see them?”

She replied, “Well, how about now?”

When I got to her home, I found out it was her anniversary ring and wedding ring. I said, “I can't take those!”

“Really, I want you to have them. I can't pay the rent.”

“But what if you reconcile?”

She answered, “We won't,” but I said, “You just don't know. I really hope you will.”

Now this kind of thing tugs at your heart a bit, so I said, “Tell you what—I'll keep these for you. I'm a free pawn shop. I'll keep them a couple of years, for free. If you ever want them back, just pay that rent—no late fees, nothing. Just take them. I don't want your rings.”

The woman responded, “Oh no, I'm not coming back for those.”

I protested, “Well you never know. You might work it out. I want you to work it out.”

She answered, “No, no, you don’t understand. I've been divorced twice now—from him.”

She never came back for the rings, and I still have them. Maybe one day I'll have them reset for my daughter. The point is that you just never know what you’re going to end up with in this business.

Finding the Best Leads for Tenant-Buyers

Finding good tenant-buyers is the key to making the deal successful. There are many ways to find a good buyer for your home. One of the primary ways that I use to market my houses is to advertise in the newspaper.

Try a few different ads. If you get no response, make changes and try again. Know whether you’re in a buyer’s or seller’s market. I have a friend who said in her ad, “Free pizza.” So people would call
Finding and Qualifying a Good Tenant-Buyer

her up and say, “What’s this about free pizza?” and she would answer, “Every month that you pay your rent on time you get a free pizza.” It’s amazing what people will do for a free pizza.

How to Post a Successful Ad

When you run an ad in the paper, remember that “romance sells.” Beautiful sunsets, bring your canoe—think of something short and catchy for the ad, things that might reflect a holiday or time of the year. Or you can push on the credit issues, location, or special features of the property. There are many ways to reach buyers. Try different approaches to see what works for you. If one ad doesn’t work, try another; if one paper doesn’t work, try another paper.

Rent with option to buy this 3 bdrm, 1 bath home in Xyz Town near Xxx Park. Large yard and view of lake. $1595/month and $5000 option fee gets you in. Bad credit OK. (111) 222-3333

This is a very basic, generic ad. It should appeal to a broad range of potential buyers.

Bad credit, no credit, poor credit? We can help. We have homes in this area to help you get your credit reestablished. Own a home soon! Small amount needed to get in. (222) 333-3333

This ad will bring in the buyer with bad credit. We are trying to find someone with poor credit—not a deadbeat, just someone who needs another chance.
This is the romantic type of ad. It is meant to draw in the romantics, young couples, and the like. Each buyer responds to different ads, just like the sellers.

Buy your family a new home in 20XX! Start out fresh! Own a home now! 3bd 2ba in XYZ Town with great schools. $995 month and low amount required to get in. Call today. No bank qualifying. (333) 444-6666

This ad is great to run at the end of the year or the beginning of a new year. It is perfect to work on people's New Year's resolutions.

Stop Renting! Buy Now! We have several homes available with lease option terms. ABC and XYZ Counties. Start building your future today. Homes ranging from $995 to $1995. We can help YOU! (222) 333-4444 www.MajesticRentals.com

This ad contains my company web site, which is always good to put in an ad if you have one. Web sites are one of the cheapest ways to advertise, as I discuss a little later in this chapter.

Note that if you are a Realtor, you must disclose that in your ads.
This is a great ad for parts of the country where the words “Land Contract” are used for seller financing. If your part of the country doesn’t use this term, then substitute the words “Seller Financing.” This attracts people who don’t feel they can get a mortgage. They know they will need the seller to assist them in their financing. We are not going to give them seller financing or a land contract, but we are attracting them with these words. We will discuss with them later that we are doing a lease with an option to buy and that they can clean up their credit to get a mortgage during this time period.

**Referrals from Realtors**

You can also get Realtors to refer buyers to you. Realtors usually only work with buyers who can get a mortgage today and can go purchase a home from them. If they don’t have a preapproval letter, then they basically throw the buyer’s name away. I created a letter with the heading “A Piece of Garbage or $1,000?” The offer in this letter could be $500 or more than $1,000. The intention is to get Realtors to give you the names and numbers of the people who come through their doors that they can’t help—people who can’t go buy a home traditionally through their office. If they refer them to me and they buy a home using a lease with an option from me, then I will give the referring Realtor the amount stated in the letter when the buyer moves into one of my homes. You can also entice Realtors by offering them more on the back end if the person actually buys the home down the road. Realtors have leads on lots of these types of buyers. If you can’t find them yourself, or if you need more, then consider offering to pay more. These are also the Realtors I work with when finding sellers. Now you can see how powerful it can be to work with Realtors. They can bring you sellers and they can bring you buyers.
STEPS TO SELLING PROPERTIES ON LEASE OPTIONS

Web Sites

A web site is one of the best ways to show your prospects the details of how options work, but also the details of a particular home. Your web site can also be a place where you show all of your properties, when you have several to offer. It is an inexpensive way to advertise your homes. I am not a technical person, nor do I want to be one. You can buy a web address for a low annual fee and hire high school or college kids to get a web site set up for you. They are not expensive, yet they can provide the viewers with a lot of information on your homes and services that you can’t afford to print in a newspaper. Most people have access to the Internet and have an e-mail account, so you have a huge potential audience.

Signs

Post signs in front of your homes that say “Lease to Own,” “Rent Option,” “Lease or Buy,” and so on. Also, if you have a rental home that is on a busy street or on a corner lot, write into the lease with that tenant a clause that allows you to put a sign out front to draw in tenants for other homes you have. Signs in front of homes do bring in calls for that home or for others.

Referrals from Tenants

Offer your current tenant-buyers free rent or option credit if they refer a friend who lease options from you. I prefer the option credit, because it is not cash out of my pocket and it entices them to purchase the home. If they don’t purchase it costs me nothing; if they do, it comes out of my pocket later.

There are many other ways to find tenant-buyers, so experiment and see what works best for you.

Types of Tenant-Buyers and Their Credit Situations

People can have many types of credit situations. The four types I discuss here are (1) good, (2) deadbeats, (3) Bad with reason, and (4) unknown.
When a person has perfect or good credit, they don’t need to consider a lease option. This technique is not necessary in order to buy a home. People with good credit can work with a Realtor and buy any home they can afford. They can also find a home for sale by owner and work directly with a mortgage broker to get a loan. They have many choices, so they don’t need this technique.

The opposite of good is bad. Deadbeats are those who have poor credit and no excuse for it. They have the money but they just choose not to pay their bills on time or at all. They tend to be poor money managers, or they are lazy and don’t want to work to pay minimal bills. These are not the type of buyers you want in your home. They need to make habit and lifestyle changes, and you will not be the one to make it happen. Deadbeats are deadbeats—you don’t need them!

Then there are the people who have poor credit for a reason. They are good people to whom something bad happened. Bad credit can result from many different situations including loss of job, divorce, medical problems with no medical insurance, disabilities, and so forth. These individuals have hit bottom financially and are on their way up again. They have improved their situation, but not enough to go and buy a home yet. These are the types of buyers you will want buying your lease option homes.

Bankruptcies are at an all-time high in our country, according to www.uscourts.gov/bankruptcy/statistics. When people file for bankruptcy they may not be able to get a mortgage for several years after the discharge. People with collections or late pays on their credit report need time to heal these situations. Many people don’t want to wait until they can qualify for a mortgage. This situation makes the selling of lease options an opportunity for us real estate investors. People want to buy now but can’t. They are willing to pay more for a home on an option and have it now than to wait and save money. It is the common “we want it now” mentality.

There are two things many people ask themselves when buying a car: how much down and how much per month? If those two things fit in the budget, then they buy the car. Whether the price of the car is $28,000 or $26,000 is irrelevant. It’s the same way with homes: The end price is not as important as the terms. Lease options give terms to people with less than perfect credit.

The people that fall into the “unknown” category need to be evaluated more carefully. They have poor credit but it is unknown as to...
whether they have improved their situation. The credit is still bad, but there is a reason. I recommend you stay away from those people or have a lender evaluate them first. If a lender can’t tell you that they are improving and will have a chance to get a mortgage, put them on hold. Wait a few months and then reevaluate their situation to see if it has improved or changed. We want the people who simply had something bad happen to them and are on their way to repair and improvement.

Qualifying the Good Buyer

When you run a credit check, you are looking for someone who had a blip in their credit and now they are on their way to financial stability. When you look at someone’s credit record, see if they are on their way up or not. Notice what they have paid recently and what is still behind—this will show up on their credit report. Learn to read credit reports and get set up on a reporting system that works for you. If you don’t know which system to use, talk to others in your real estate investors group. They will know which companies provide which services in your area. You can also work with a mortgage broker to run credit and do the lease option approvals.

Your Standards

It is a federal law requirement that landlords put their rental standards in writing. If you don’t have your standards in writing (and, unfortunately, few landlords do), you are liable to end up in a pickle if someone accuses you of violating this rule. Your standards do not have to be complex but should be able to be produced if someone at a local or federal agency, or anyone off the street, requests a copy of them.

Written standards can be as simple as this:

Qualifications for Tenant Selection for Majestic Realty, LLC—Lease Options

- No landlord tenant judgments unpaid.
- Ability to pay all outstanding judgments/collections.
- Good landlord reference.
Finding and Qualifying a Good Tenant-Buyer

- Gross monthly income equal to three times monthly rental rate.
- If any bankruptcy, it must be discharged.
- Option fee available or must be negotiated/financed.
- Prefer they have spoken with a mortgage representative.

On my lease option standards I don’t put a credit score, but I do state that if they have a bankruptcy it must be discharged. I also don’t put length of employment, but you can. These are only my standards for lease options—my standards for my regular rentals are stricter. You must establish your standards and they must be in writing.

Screening a Good Buyer

Screening a buyer is extremely important, and yet some of us investors still go by instinct or illegal decisions.

“We liked them,” some investors will say to me. We want to buy from sellers that “like” us, but we can’t sell that way. There are too many good liars in the world. You may feel you can read people, but relying on your gut feel will set you up for a rude awakening. Many of my worst situations arose from my own desire to believe in people. We should all screen people as if we were blind and deaf. Then we would screen them strictly on the facts and not our opinions or prejudices.

Screen a tenant by reviewing their application thoroughly. Check it for accuracy and make sure they did not lie to you. If someone lies to me, they are denied the occupancy. Check their name—get a copy of their driver’s license. Check their landlord history. The current landlord may want to get rid of them, but the previous landlord has nothing to hide. Call them both. Confirm it is the real landlord in one of two ways: check it on county records, or call the person and mention a different amount of rent than on the rental application. For example: “Hi, my name is Wendy, and I’m calling for a reference on your tenant named Joe Smith. Can you tell me how long he has rented from you? How does he keep your home? Has he been a good tenant? Would you rent to him again? Also, I see he pays you $900 per month, right?” Actually the application says $700 or something else. If this is Joe’s friend, he will say, “Yes, that is right, $900 per month.”
If it is the real landlord he will correct it: “No, Joe only pays $700. Did he say he paid $900?” Then I say, “Oh, no I see you are right. It does say $700—I misread it. Thanks so much for your information.”

Check their employment, too. I use the same technique when I verify their income as I do their rental amount. When I contact the employer I say “Joe put on his application that he is making $16 per hour—is this correct?” when he actually put $12 per hour. If the person you reached is his employer and not his buddy, they will correct you on this one. On occasion I will also ask the applicant for recent pay stubs to put in the file. This information is also handy to have in case you ever have to garnish wages. Be sure to verify hours they work and time on the job as well. Also check their banking information—you might need it later.

**Know What Are Reasonable and Unreasonable Expectations**

Many of my tenants have pets, and most of them smoke. For this reason I never say “No smoking” and “No pets” because I wouldn’t have many tenants. Smoking and pets don’t make people bad prospective tenants. However, here are some things to look for on their application that are potential smoking guns for bad tenants:

- Why did they move? When prospective tenants say they had a “bad landlord” before, it puts up a red flag for me. I know there are bad landlords out there, but the red flag it raises is that they are blaming someone else for their problems. So I look further to see if there are other instances of blaming. If their business went into foreclosure, are they blaming their accountant? If they have tax liens, are they blaming the IRS? Be especially watchful for the blame game.

- How long have they had their current job, and how long did they have their previous jobs? What salary are they currently making? If they haven’t been employed very long in their current situation, call their current employer to get an employment verification. Get the verification from an executive in the company or from the CPA/accountant. Do not get it from the receptionist! Get the start date of employment as well as the current salary.
Finding and Qualifying a Good Tenant-Buyer

The Credit Report

Run a credit report and see what’s going on with their debts. Some people may have medical issues that have caused their current financial difficulties, but most mortgage brokers will overlook these. What is more important are repossessions, foreclosures, bad credit card debt, judgments from landlords, and the like. If they have a string of bad debts, you could be the next bead on that string.

The credit reports I receive have bad debts shaded and good debts in white. I like to see a lot of white on the page. Too much shading indicates a lot of current and potential future problems. Do they have frauds on their report? Do they have bankruptcies on their report? This is not necessarily a deal breaker, as bankruptcies can happen to even the best people and can sometimes be out of their control. However, the important question is, what are they doing to repair the bankruptcy?

Criminal Background Check

I don’t run criminal background checks, even when the tenant looks like what I would consider to be a criminal. If you do one, you must do them for all prospective tenants.

I remember when one of the first homes I ever bought was up for rent. Two rough-looking guys on Harley Davidson motorcycles drove up right onto the lawn and wanted me to show it to them. I was just 21 years old and feeling a little intimidated by these big, scary guys. They ended up renting the house, however, and they paid their rent perfectly and on time every month, as well as leaving the house better than when they rented it. Looks simply don’t count. You must turn a blind eye and only focus on the qualifications on paper. In that spirit, you should also be thoroughly versed in the current fair housing laws.

What You Should Know About Fair Housing Laws

Fair housing laws could be the subject of an entire seminar. Realtors around the country have half- to full-day training sessions on this topic alone, because fair housing rights, when violated, can cost the violators hundreds of thousands of dollars. This is not an area where you want to mess up.
The bottom line is this: Select a tenant on their application alone and nothing else. There are federally protected areas and there may be some state protected categories also. Each state has its own protected areas, so check with your state for the details. Your local real estate investors group can help point you in the right direction. The simplest way to be safe is to refrain from judging anyone by the way they look or talk. This is why I say that we should be blind and deaf when selecting a tenant. If we evaluate on the application process alone, we will stay out of trouble. Make the selection based on the facts, not on gut feelings or instincts. Stick with the law and you will be safe.

Some federal and state protected categories include (but may not be limited to):

- Religion.
- Race.
- Nationality.
- Sex.
- National origin.
- Color.
- Sexual preference.
- Marital status.
- Age.
- Weight/height.
- Familial status. While you can’t ask potential tenants how many children they have, you can ask how many people total will be residing in the home. You don’t have to rent your two-bedroom home to a family of nine.
- Mental and/or physical handicap.

Be extremely careful with this area of federal and state law. Even an inadvertent misstep can haunt your career for a long time.

Rejecting a Rental Applicant

If you reject someone’s application, you have to tell them why you rejected them in writing, and there is no need to obscure your reasons.
Finding and Qualifying a Good Tenant-Buyer

Be honest but be kind. Let them know that if they can clean up some of their credit difficulties, you may be able to help them in the future. If you feel inclined, you might even suggest they talk to a lender or financial counselor about how they can get their credit report into a more favorable position.

Buyer’s Objections

Although tenant-buyers will rarely have any objections to renting from you, there are a few that may come up. You will need to know some ways to handle these objections and what you can say to your tenant-buyers. Here are two of the most common:

1. What happens to my option money if I don’t buy this home? Answer: “It’s nonrefundable. This house is going off the market during the option period, so there’s a fee for that. We are providing a service, and for this service there is a fee. If you are not sure you want to buy this home, you should not put an option fee down. You should rent from someone else. We want to rent this home to someone who wants to buy it in the future. You do want to buy one day, don’t you?”

2. What if I can’t get a mortgage? Answer: “Then you would lose your right to buy this home. We do have the right to extend or give you another chance to buy this home, but at this point we are not guaranteeing anything. If the market goes up, we also might increase the price of the home. We are only fixing the price and terms during the time period we have signed here today. You should talk to a mortgage broker before you sign any contracts. It is usually a requirement of all lenders that the applicant pay off judgments, liens, and collections before they can qualify for a mortgage.”

I don’t want the potential tenant to delay making a decision, so I always say that I have other people looking and that my ad is still running, so they need to decide what they’re going to do and how interested they really are. After all, they are the ones in need, not me.

There are times when you will find the buyer does not have the full amount to put down on the option fee. Be creative with the option
fees. I've taken two mobile homes in trade for option fees. I'm not in the mobile home business and I hate them, but it got the deal through! You can also work on monthly payments with them. You can take an extra $200 per month toward the option fee until it is paid in full; however, you should always get more up front than what you would have received if you were getting a security deposit. Don't ever do less than that.

Once you have your terms determined and your good tenant selected, you must get the paperwork ready and signed. Get them locked in and set for the move-in date!
CHAPTER 13

Getting the Paperwork Ready for the Tenant-Buyer

Approved!

Once you have approved a tenant for your lease option home; all you have to do is draft the paperwork and have them sign it all. You need not give more than 12 to 18 months to the buyer on an option. This time frame is most often enough for a good option tenant to get a mortgage. For you, there is a benefit in keeping it short-term in appreciating markets; or if you want them to cash you out. Whatever appreciation is written into the contract is what you have to honor, regardless of whether the market is higher. Additionally, appraisers have a 5 to 10 percent leeway on appraisals. While I could structure a long-term option deal that said the value of the mortgage would be dependent on the appreciation growth rate, by whose appraisal would it be valid? If it’s my appraiser, the buyer may feel taken advantage of, and if it’s the buyer’s appraiser, the appraisal might be too low. So keep the term short and avoid problems.

If at the end of the time period your buyer wants to extend, you can do so at your discretion. This can also be an opportunity to renegotiate. If the homes in that area have appreciated more than you expected, then you would want to extend, but increase the purchase
price somewhat. You could also ask for another $500 to $3,000 option fee for the convenience of extending the option. Finally, you could raise the rent slightly. Sometimes I have given my tenants an extension for free, because of certain circumstances. There are also times when I have said no.

You can’t predict what the market will be like in the future, so getting further out than 12 to 18 months can be more risky for you, and you forfeit your ability to sell the property outright at the end of the option.

If it is more than a few days between the end of the option and the day they plan to move into the home, your best bet is to get a non-refundable deposit from them to hold the home until the move-in date. This protects you from them changing their minds at the last minute. A personal check at this time is okay if it has time to clear before the move-in date. Make a photocopy of the check to get their bank account information. If they end up ditching the home and owing you money, you will know where to garnish their bank account (available in most states).

Have all the forms printed and ready to go. Get the tenant to sign early if possible. Depending on how busy you both are, try to get all the forms signed after they give you the deposit.

When you are working with the buyer, you are the landlord to them. You are also the seller, as far as they are concerned, because you have set the terms for the sale including the option fee, the monthly payment, and the sale price. You need to use pro-seller forms. These are forms that specifically favor your end of the deal as the seller.

At the beginning of this deal you have either optioned the home from the seller and have in turn optioned it to a tenant-buyer or you own the home outright. As with the purchase process, it’s helpful to use a checklist to make sure you don’t miss any steps.
Getting the Paperwork Ready for the Tenant-Buyer

Selling on an Option—Checklist

| Address: ______________________ |
| Move-in date: ___________________ |
| Seller name: ____________________ |
| Phone: ________________________ |

1. Advertise home ___
2. Get application fee ___
3. Get application ___
4. Confirm applicant meets criteria ___
5. If not, send rejection letter ___
6. Get nonrefundable deposit and nonrefundable deposit form if accepted ___
7. Create tenant folder ___
8. Draft contracts ___
9. Videotape home or take pictures ___
10. Get check-in/out list ___
11. Sign contracts ___
12. Sign the lead-based paint disclosure ___
13. Sign the seller’s disclosure ___
14. Cancel advertising ___
15. Confirm utilities in their name: Water ____ Gas ____ Electric ____ Water Softener ____ Other ____
16. Confirm check-in/out returned ___
17. Confirm they have renter’s insurance ___
18. Remove sign and lockbox ___
19. Make a copy of tenant’s check for tenant file ___
Some of the checklist items will be self-explanatory, but let’s look at each of them.

1. *Advertise the Home.* This is discussed in Chapter 12.
2. *Get Application Fee.* You decide how much. I charge $20 per person over 18 years old.
3. *Get Application.* Make sure they fill out all areas of the application completely. My application requests information on each applicant over the age of 18, even if they are not working. It asks for their driver’s license number, Social Security number, employment information, banking information, landlord or current address information, and previous landlord information. The more information you can gather, the better off you will be if you ever need it. It is not so much needed for your evaluation, because that is done on the standards you have set in Chapter 12, but if you ever have a problem with a tenant and need to collect from them you will want complete information on this application. Make sure it is completely filled out and signed by all parties.
4. *Confirm Applicant Meets Criteria.* See your standards from Chapter 12—this is a simple yes or no.
5. *If Not, Send Rejection Letter.* A rejection notice is required by law whenever anyone applies for credit or a place to live and is turned down. You must specify why someone is not accepted, whether it be landlord history, income status, credit issues, or anything else not federally protected by law. You must be specific.
6. *Get Nonrefundable Deposit and Nonrefundable Deposit Form If Accepted.* Once someone has decided they want to move into one of your homes but they don’t plan to move in for a couple of weeks, be sure to get a nonrefundable deposit. This is separate from an option, but it will be applied toward their option later. The nonrefundable deposit holds the property for them and demonstrates their intent to rent it. Later if they don’t sign their contracts or move in, they would lose this deposit.
7. *Create Tenant Folder.* This will be a right-tabbed red folder. I call this the tenant folder, whereas the green ones are for the owners. I use legal size, half-tab folders and put the address on a white label with a red strip above the address; you could also write the address in
red or green. All information about the tenant and their contracts and correspondence will go into this folder.

8. **Draft Contracts.** Draft the rental agreement, option agreement, offer to purchase, pet agreement (if applicable), lead-based paint disclosure, and seller’s disclosure, and any other state required forms.

9. **Videotape Home or Take Pictures.** Do this with the tenant if possible. I suggest that you take a video camera with you when you are showing prospective buyers the home. Say things on the video like “Marie, what do you think about the kitchen cabinets? What do you think about the bathroom tile? What do you think about the closet doors?” and have the date recorded on the video to prove everything. Then Marie can’t come back later and say, “Those kitchen cabinets were trashed” when she said on the video that they were fine. Any pictures that you take should be kept on a CD in the tenant file for that house. After I take digital pictures of the home, inside and out, I put the CD into a CD holder inside their file. Those pictures are to protect me later if they don’t buy the home and have done damage to it.

10. **Give Check-in/out List to Tenant-Buyer.** The check-in/out list is a form the tenant can fill out to evaluate the condition of the home when they move in. This gives a baseline of the home and its condition. It is to protect you both in the event that they don’t purchase the home and they decide to move out. It will spell out the condition of the home at the time when they moved in. Each state has different requirements as to what judges will require and allow, but the more you can show on the condition, the better off you will be if you are trying to collect on damages the tenant has done. Go overboard versus “underboard” on documentation and pictures. You
STEPS TO SELLING PROPERTIES ON LEASE OPTIONS

hope you will never need them, but if you do, you will be glad you have them.

11. Sign Contracts. The buyer must sign each of the contracts with you. If, however, they have already paid their nonrefundable deposit, I will allow them to take the contracts and review them. They must sign before they move in.

12. Sign the Lead-Based Paint Disclosure. See Chapter 7 for more detail. However, you can create a new one that is blank and says you don't know anything about lead in the home, if this is true, and sign it. You can also attach the previous owner's lead-based paint disclosure and have the tenant-buyer initial it to acknowledge they have seen it. This disclosure is required by federal law.

13. Sign the Seller's Disclosure. If this is the first time you have rented this home, you may not know much about it, so you can write on the seller's disclosure that you have never lived in the home and that the buyer should do their own inspection. Add that the home is being sold "as is." However, I also recommend that you attach a copy of the previous seller's disclosure to yours and have the tenant initial it. After all, you do know what the seller disclosed to you, and you need to disclose everything you know. Also, if you have had it awhile and the roof has leaked, you must disclose that, even if you fixed it. Don't skimp on this crucial step. Many lawsuits are filed because sellers knew about problems and didn't disclose them. If you had a leaking basement and fixed it, you need to put that on the seller's disclosure. It won't stop anyone from buying the home if it was fixed, but if it leaks later and they find out it wasn't disclosed, you will be fixing it again; if it was disclosed, they will be the ones fixing it.

14. Cancel Advertising. Cancel any advertising you have been doing for this home. Sounds simple, but it can be expensive. I have forgotten to do this, and it can cut into your profit if this is not on your checklists.

15. Confirm Utilities Are On. Once the tenant has moved in, make sure they have transferred the utilities into their name, including gas, water, electricity, and water softener.

16. Confirm Check-in/out Returned. Make sure you follow up and get this form returned from your tenant-buyer. If there is anything on the check-in/out list that needs to be addressed, take care of it.
17. Confirm They Have Renters Insurance. If not, continue to follow up in writing with them and put a copy of each request in their tenant folder. It probably won’t be a make or break for you, but if something were to happen to their personal belongings, for instance, you will have all the proof you need that you tried and tried to protect them, but they failed to protect themselves.

18. Remove Sign and Lockbox.

19. Make a Copy of Tenant’s Check for Tenant File. You might need this later if you need to garnish their bank account, if they are a good tenant who turns bad.

**Always Check Your Paperwork!**

My partner, Debbie, and I purchased a property on Newman Street. The little house had 900 square feet with a walk-out basement to Paint Creek. The owner was an older woman who had split the lot, and a developer was going to build a home on the vacant part. The vacant lot was the same size as the one with the house. When we bought the property, I knew up front that the owner was going to sell the vacant part to a developer. We lease optioned the house to a couple who gave $5,000. As happens many times, everything was going perfectly and it seemed like they were going to exercise the option. Sixteen months or so into the lease option, the couple called me and insisted, “You have to sell us the other property too.”

When the couple first signed the lease option, I had physically walked the property with them and showed them what Debbie and I owned and what we didn’t own, including the fact that we did not own the undeveloped part. They still said, “You have to sell it to us.”

Standing firm, I reiterated that only the house and the property it sat on were included in the lease option, not the vacant split property.

At the end of their 18-month option they not only didn’t exercise the option but they stayed on an additional three weeks without paying and then moved out. I sued them for $900 for unpaid rent. They countersued for the refund of the lease option money, again insisting that it was their right to buy the entire property. It cost me $1,500 in legal fees but the judge awarded me their $900 in unpaid rent. The couple still refused to pay the rent and it ended up being scheduled...
STEPS TO SELLING PROPERTIES ON LEASE OPTIONS

with a mediator. Then the day before the mediation for $900, the couple called and paid it. End of story? No!

Two weeks later I got a call from the woman we bought it from, who said, “We’ve got a problem. You own my vacant lot.” It turns out that when I bought it from the seller through Century 21 and the title company, both parts of the property had been deeded to us, although the vacant part was not supposed to have been deeded. We actually did own both parts of the property, just as the wife had insisted, and if they had actually exercised their option, they would have owned both parts. It turns out the wife worked for a mortgage company and had probably checked and thus, understandably, thought I was lying about not owning the other part of the property even though I honestly thought Debbie and I only owned half. I had taken the deed I received from closing, copied the legal description for the entire parcel, and put it right on my copy to her. After the case was settled, I deeded the vacant part back to the original owner. The moral of this story is to always check your paperwork, especially legal documents!

What You Need to Know about the Three Essential Contracts

Each state may require certain information for rental and purchase agreements. My contracts are generic enough to use everywhere, but they should still be reviewed by an attorney in your state. Each state also has its own landlord, tenant, and security deposit laws. Therefore, as recommended in Chapter 7, you should seek the advice of an attorney if you are using any generic contracts for your state to buy, sell, or lease real estate. I recommend Pre-Paid Legal attorneys at www.prepaidlegal.com/hub/wendypatton. They have plans starting at very reasonable rates per month to give you legal assistance. I have been a customer since 1988 and have saved thousands of dollars on legal questions, contract reviews, letters, and so on, for real estate matters and in multiple states. Each state has its own rules and regulations regarding rentals, lead-based paint abatement, evictions, and so forth. There are so many more clauses when you are selling, especially the rental agreement, because there are so many more things you will need to do to protect yourself. When you are buying, the
Getting the Paperwork Ready for the Tenant-Buyer

rental agreement is very short; when you are selling it is very long. Here are some of the clauses that have been my favorites over the years in my contracts to sell on lease options:

- The option agreement: On the buying side, the option agreement turns control of the property over to the optionee without ownership. When I am doing a lease option, I sign an option with the buyer. I control the property as if I owned it, but I am giving them the right to buy upon exercising the terms of the option, usually in 12 to 18 months.

- The rental agreement: The rental agreement specifies how long the tenant will rent the home and how much they will pay each month in rent to me. During the rental period they can purchase the home, unless otherwise specified. A rental agreement also comes in handy if ever taken to court, so that no matter what the tenant has put into the property, the judge will let me evict if necessary rather than foreclose.

- The purchase agreement: This agreement sets the terms of the final sale. Again, there are two of these—one for my deal with the buyer, and one for my deal with the tenant-buyer. The deal with the buyer sets the sale price upon exercising of the option. On the tenant side, the contract also has a specific sales price, and because you set the terms of the lease option, that price will be higher than the price you have with the seller.

Points to Consider for the Option Agreement

It is important to get the optionee to be as responsible for the maintenance and well-being of the house and property as possible so that you are not tied down with constant maintenance. Here are some points in my option agreement:

- Optionee agrees to accept the property in “as is” condition.
- Optionee agrees to make all repairs major and minor to the property.
- If the optionor has to make any repairs to the property, the cost of the repairs will be added to the purchase price. (If someone's water heater or furnace goes out and the tenant can’t afford to
fix it, you should go ahead and pay for the repairs. In Michigan, you just can’t go without heat in the dead of winter.)

- If there is a septic system, the optionee agrees to have it pumped once per year.
- If there is a pool, optionee agrees to open and close the pool each year and to maintain the pool.
- Optionee should pay for all additional assessments, including water, sewage, sidewalks, and road paving.
- The option can become void if the optionee pays their rental payment or any option payment more than 10 days late. (It is important to remind your tenants that their record of payments will have to be submitted to the mortgage company and may damage their ability to secure a mortgage. So, if they’re serious about owning the home, they need to be serious about paying on time.)
- If the option is voided for any reason, then the contract becomes a month-to-month rental-only agreement (so that I can take steps to resell the property if I choose to).
- Optionee agrees not to record anything against the title of the property. (In other words, the tenant cannot file a Memorandum on the property. The memorandum is used only when you purchase, not sell.)
- Optionee understands that optionor does not hold title (own) this property, but is transferring their interest in the property. If optionor can’t transfer title due to something out of their control (i.e., owner refuses to close or can’t transfer clear title), optionor will reimburse optionee the entire option consideration plus an additional $500 for their inconvenience, as full and complete liquidated damages for optionor not being able to close on this property.
- **Equitable mortgage**: This Option to Purchase is not, and shall not be construed as, or interpreted as any form of equitable mortgage. It is hereby declared that it is not the intent of the parties to create a loan of any nature or to create a mortgage of any kind. In the event that the optionee hereunder should ever raise such an issue in a court of law or otherwise this Option shall terminate immediately.
Getting the Paperwork Ready for the Tenant-Buyer

- Optionor has advised the optionee to seek the advice of a mortgage lender and attorney prior to signing this document. (The mortgage broker might look at their credit and their history and tell them that even with an 18-month option they will not be able to clean up their history enough to qualify for a mortgage. They should also always have a lawyer look over any type of document that commits them to an agreement. In my experience, most people talk to neither, but they sign the document saying that they have.)

Points to Consider for the Rental Agreement

The rental agreement gives the tenant the right to occupy the property during a specified time period. It is similar to the rental agreement you signed with the owner/seller, except obviously your rental agreement with the tenant will be very pro-landlord (pro-you).

The rental agreement needs to be separate only for selling on an option. If you are the buyer, you certainly can put them into one document, but when turning the option around, you’ll want to use the three different documents. The reason is that if the tenant doesn’t pay, or the deal goes south, you will want to be able to evict them as quickly as your state allows. If you have all three agreements in one contract, some judges will look at the lease option as a sale rather than a lease, and therefore make you go through a full foreclosure or forfeiture process versus an eviction. This will take much longer, be more expensive, and may require an attorney.

Anyone who will be residing on the property over the legal age must sign the rental agreement. This includes children of legal age (determined by the state).

A cosigner can be an important safeguard if you have a weak applicant and they have a strong parent or friend who is willing to sign with them on their rental agreement. It works well for giving liability to someone else who will come through with the payments. I have a situation where a mother cosigned for her daughter. It was just a rental but the daughter had terrible credit. The mother, however, had worked for General Motors for 25 to 30 years and made a good guarantee person for me. The daughter stuck me for nearly $5,000 in unpaid rent and damages, and now the mother is paying for it out of her GM checks. In another case, the mother was a local Realtor in Michigan, and she asked
me to help her daughter get a house. Her daughter had been through a rough time, and the mother was willing to cosign. I probably didn’t even run the daughter’s credit because I knew the mother was a well-known Realtor and was good for whatever might happen. The mother paid the $5,000 option fee, and the rent was $1,300. Eventually the daughter left, owing me $3,000 in unpaid rent, and the mom had to pay it off.

I like to make all rent due on the first day of the month. If a tenant moves in on the seventh, I prorate the rent for the month. My rental agreements specify late fees of $25 for the first day late and $5 per day afterwards, and the tenant, of course, must sign the agreement to this. I can’t reiterate enough how necessary it is to have everything in writing, spelled out in detail. That way your tenant can’t say, “I never agreed to that.” All you have to do is point to the contract and say, “Here it is in black and white, and there’s your signature underneath it.” I also like to add an incentive to encourage my tenants to pay on the first of the month. My contracts state that if they make their monthly payments on time, including any unpaid option fees, then I will credit them with $100 towards the purchase price of the house.

Your other fees on the property can include a pet deposit, security deposit, cleaning fees, and the like. In a lease option, I usually do not require a security deposit, because if they have an extra $1,500 for a security deposit, which is refundable, I’d rather have them apply that to the option fee, which is nonrefundable. There are some good reasons and areas of the country where even a small security deposit is recommended. It gives the tenant something they can get back if they don’t purchase. Some judges like a small amount showing as a security deposit. None of the option fees, however, show up on the rental agreement, as the option agreement is a separate document.

Your rental agreement should state the total cost to move in. For example, if there are fees, you will add them to the first month’s rent to get the total for the rental agreement, but that is not the total overall cost since you also need to add in any security deposit. The rental fees plus the security deposit make up the total move-in costs. The rental agreement must also show the total amount of anticipated rent for the contracted period, including prorated months.

You can also state in the agreement that if the rent is more than 10 days late, the agreement may revert to a month-to-month rental (nullifying the option) at the discretion of the landlord. I generally don’t do this unless I want to get rid of the tenant, because when this alterna-
Getting the Paperwork Ready for the Tenant-Buyer

tive plan is set in motion it allows the tenant to move out at any time. Be sure your rental agreement states that the keys are due back within 24 hours if the tenant does not exercise the option and/or moves out.

Payments should be postmarked by the post office rather than a Pitney Bowes machine, as these machines can have their dates changed. In my rental contracts I also specify that any bounced checks are subject to an additional fee. Although I start out trusting my tenants and allowing them to pay with personal checks, if one check bounces, all payments after that must be paid in certified funds or bank checks only. I also tell them that if their rent is late twice within a 12-month period, their monthly rent will increase by $25 per month.

You should specify to the tenant how their payments will be applied, and in what order:

1. Outstanding dishonored check fees.
2. Outstanding late fees chargeable to tenant.
3. Outstanding legal fees, court costs or both.
4. Outstanding utility bills that are the tenant’s responsibility.
5. Any damage caused by tenant.
6. Collection agency fees.
7. Costs for re-letting the property, if applicable.
8. Option fees owed.
9. Rent.

You should apply their payment toward rent last because it is easier to evict on unpaid rent than on unpaid utilities. So use their money to pay for unpaid utilities, and if the rest doesn’t cover the rent, you can begin eviction proceedings in most states. Again, check with your local investor group or a local real estate attorney on landlord eviction laws.

Additional Issues to Cover in Your Rental Contract

Occupancy  The contract needs to specify that the premises will be used as a residence with a specified number of adults and children. The premises will be used for no other purpose without written permission by the owner. Having any guest staying more than 14 days
will be considered a breach of the agreement unless the resident tenant receives written consent from the landlord. I also don't allow them to use the premises for a home business without my permission. A lot of people have home-based businesses, and that's not a concern except if they have customers coming in and out of the home, which creates a potential liability issue. So check with your tenant to see what kind of home-based business they will have.

Pets  I make sure that they sign an agreement with me about having pets on the premises. I need to know, for example, if they have pit bulls or any other potentially dangerous animals on the property. It doesn't matter to me if they do have pets, and in fact almost all of my tenants have pets—I just need to know about it.

Entry and Inspection  This gives you the right to enter the property at reasonable times and with reasonable notice to inspect the premises. It’s not that you are inspecting their personal lives but that you want to make sure the home and property, which do not yet legally belong to the tenant, are maintained in accordance with the rental agreement. You also may want to show the home to prospective new tenants or buyers. If the tenant decides not to exercise, you want to have the right to affix “for sale” signs on the front lawn, but you shouldn't even step onto the lawn without calling the tenant first. This is violating their rights to peaceful enjoyment.

Assignment and Subletting  I do not let my tenants sublet or rent any portion of the premises without my prior consent. The subletter’s name is not on the rental agreement.

Joint and Several Liability  Anyone who signs the contract is 100 percent responsible for all the points within the contract up to the total amount due. I had three men who signed the agreement and all three split later. I was only able to find one of them and I told him he was 100 percent responsible to fulfill the agreement. He felt he should only be responsible for one-third, but this inclusion of joint and several liability protects the landlord from having to find all the tenants. If one can be found, that one is 100 percent responsible.

Maintenance, Repairs, and Alterations  It is the tenant’s responsibility at all times to maintain the residence and property in a clean and san-
Getting the Paperwork Ready for the Tenant-Buyer

itary manner including fixtures, equipment, appliances, furniture, and all other furnishings. If they should choose not to exercise the option, the residence should be left in the same condition as originally rented, normal wear and tear excepted. Residents are responsible for changing the furnace filters and the batteries in the smoke detectors on a regular basis. Residents should be responsible for the maintenance of the property and the house costs. The tenant cannot make major changes to the structure until he owns the property. I had one resident who tore off an upper decking because he decided he didn't want it, and I had to pay for it and then rebill him because I didn't own that house. The resident also cannot paint, hang wallpaper, or make any other changes without my consent. I had one tenant who repainted the inside of the home navy blue, and then left after two months. I had to sue to recoup my costs for repainting the home. Residents must also be responsible for the cleaning of sewers and drains that have become blocked due to their negligence in keeping them clean.

If the resident damages any windows or doors, it is their responsibility to replace those items immediately. If the resident hasn't repaired the items within seven days, I will replace the items and charge the resident for the repairs, and these costs will be due immediately. I tell my tenants that any repair under $10 must be reported to me and any repair over $10 must be approved in writing. In other words, they don't have an open checkbook to make any repairs they want. Make sure your tenant also doesn't run off and do repairs and then bill you for them, such as "My furnace went out and I paid the guy $200 to fix it." My furnace company might only charge $100. Also, the tenant may then try to take that repair bill and apply it against their rent. Make it very clear to the tenant that no repairs can be made without your consent if the repairs are over $10.

Appliances One of the things I list on the contract is all the appliances already in the home. I make it clear to the tenant that all the appliances in the home are there for my convenience—in other words, they belong to me. If, therefore, one of the appliances stops working and they dispose of it without telling me and then leave the home with that appliance missing, I will bill them for it. If they want to remove the appliance, I have to agree to it and I will cross it off their rental agreement with my initials and the date.
Ordinances and Statutes  The tenant must abide by local zoning laws for usage of the property. For example, they can't run a day care business at the home if it isn't zoned that way (not to mention the excessive liability that would incur). A home-based business of web site design, however, violates no zoning laws anywhere in the country. You have the right, as the landlord, to evict immediately for any illegal operations on the premises—for example, drug usage or manufacturing.

Liability of the Tenant  The resident is responsible for any personal injury or property damage caused by the resident or tenant or the tenant's visitors. The tenant is also responsible for damage due to negligence in caring for the property. If there is a fire, however, and all the tenant's property is lost, the owner is not responsible to pay for that since the tenant carries his own renter's insurance for just such an event. The tenant must keep all the sidewalks clear and clean, all access to the home free and clear, and should maintain the outside premises to be a safe environment.

Insurance Coverage  Because the owner's policy does not cover the belongings of the tenant, the owner requires the tenant to carry their own insurance against the risk of damage to their personal property. This insurance must be in place before the tenant moves in.

Defaults—Landlord Remedies  Let the tenant know that failure to comply with even one part of the agreement will constitute a default of the entire agreement. This means that the owner can immediately repossess the property.

Attorney Fees  In the event that either party has to take legal action to enforce the terms of the contract, the owner will be allowed to recoup all attorney fees permitted by law.

Security Deposit Act  Make sure that the Security Deposit Act (SDA) of your own state is in your rental contract. The SDA varies by state, and you must know what the rules are for your state. You are the one providing the contract, so you are responsible for that information.

Notices  Any notices must be in writing for your own protection, and not verbal. Notices should be sent to the residence address. If the ten-
Getting the Paperwork Ready for the Tenant-Buyer

The tenant is sending you a notice, it should be sent to the address specified in the contract (either office or post office box).

**Waiver**  Failure of the owner to enforce any part of the contract will not constitute a waiver of the contract. For example, if I waive the late fee one month, that doesn’t negate my right to enforce it the next month.

**Holding Over**  The tenant must give a 30-day written notice of intent to vacate the property.

**Additional Terms and Conditions**  Some further things you may want to add to your contract include:

- Vehicle limit.
- No motorcycles (some can violate the city noise ordinance).
- No working on the car on the premises. All repair work is to be done off site.
- No permanent stickers on the bathtub, and only nonabrasive cleaners to be used on the tub.
- No carpet cleaners will be used without landlord permission. The reason for this is that some of the over-the-counter cleaning solutions can actually bleach the carpet and leave a white spot.

**Make Sure Your Tenants Read and Understand the Agreement**

It is very important that you go through the contract line by line with the tenant so that they have heard everything out loud and are fully responsible for the contents when they sign their name. Don’t skip over any points of your contract, even if they begin to fidget because it takes a while. You might also ask after each point, “Do you have any questions about that?” If they want to take the contract with them, then that is okay also.

**Purchase Agreement—Offer to Purchase**

The offer to purchase should be pro-seller. Some things to consider when drafting the purchase agreement include:

- What items that were in the house will remain with the house (for example, appliances)?
If they get an FHA or other government mortgage, the lender might stipulate improvements to the property before the loan goes through. I don’t want to be responsible for that, so I say clearly in my contract that the tenant is responsible for any requirements needed to fulfill their own mortgage.

Make it clear that the tenant is buying the house “as is.”

Make sure the tax proration clause is pro-seller and is worded for your state’s standards. In other words, you want to get any tax advantage and let the buyer pay all the taxes.

Special assessments come due now if you have paid them out of your own pocket. For example, if the city has required sidewalk repair and you paid for it, now you pass that back to the buyer.

The tenant should have a home inspection done before moving in. If they waive their right to do so, I mark down the date they walked through the house.

Make sure to give the tenant the seller’s disclosure statement. This not only becomes a part of their history but it will then be handed off to the next buyer as a complete history of the house.

Include the lead-based paint disclosure and the property inventory check-in/out list.

If I can’t transfer title on their option agreement (due to no fault of my own), they get their option fees back plus an additional $500, as full and complete liquidated damages.

If you are a licensed Realtor you have to disclose it.

Anything that I have to do in regards to repairs gets added to the purchase price.

Advise the purchaser to seek the advice of a mortgage broker and an attorney before signing the purchase agreement.

The pet policies and agreements are attached to the rental agreement and signed on the same day. I have them list the names of all their pets. If one of their pets dies or is given...
Getting the Paperwork Ready for the Tenant-Buyer

away, they don’t have the right to just go out and get another one. The animal breeds should also be named. If they can give you a copy of the animals’ health and shot/rabies records to have on file, that would be helpful were there ever to be a biting incident. If the local ordinance requires licensing, then you should get a copy of that also. Typically on my option agreements I waive any monthly pet fees, but in a pure rental situation, I would not waive those fees.

- If I get a deposit on a property, it is nonrefundable if they choose not to option it. However, I do refund it they are rejected based on credit or the potential ability to get a mortgage. Most of the time I won’t even accept a deposit until I know they’re approved.
- On the rental application, verify their Social Security number, and employer information.

Be Prepared for the Tenants

On the move-in date the tenant delivers the final balance in certified funds. Don’t take a personal check except on their deposit. Once they have moved in, personal checks are okay, but not on the initial option and move-in date. The day they move in, make sure the following items have been completed:

- You have a copy of their renter’s insurance.
- You have enough keys for the home.
- Remove the sign and lockbox, if any.
- Make sure they have the utilities turned on in their name.
- You have the new phone number of the tenants.
- Have the tenant walk through the home and complete the check-in/out list.
- Take pictures of the home.

Give the tenant a move-in gift if you like. It could be a small plant, card, flowers, or the like.
If the optionee wants to exercise the option, they must send a notice in writing to my office. If however, they do not follow all the terms of the rental agreement, I can declare the option null and void. This may sound like a lot of paperwork and considerations to keep track of, but it’s all to protect you. Think of “pro-seller” as also meaning “protect seller.” That’s pro-you!
Managing the Property and the Tenant-Buyer

It’s amazing to me how many people will pay an option fee and then walk away a few months later, knowing that they have just forfeited their fees. It is equally amazing how many people will try to get their option fees back, even though they are nonrefundable. The option fees paid are for the right and privilege to purchase a home. Whether the tenant-buyer (optionee) meets the terms of the option is up to them. My goal is to get people to buy, and I’ll do whatever I can to help them, but I can’t make them responsible. I can’t make them close on the home either. Approximately half of my tenants ever get to the closing table; some walk away from their option fees after only a few months of tenancy. If they forfeit their rights, that’s their choice, but some buyers will try to get that option back in many sneaky ways.

One of the smallest houses I ever lease optioned was in Michigan. It was approximately 700 square feet and had what is called a Michigan basement—a cellar with a dirt floor, stone walls, and a low ceiling. I leased it to a man named Arnold, who moved with his wife from a larger house into this little one. You might say that Arnold was like a customer because this was the second home I’d rented to him, but he was a good renter, always paying his bills on time. However, it wasn’t but two weeks into the rental when I got the phone call with
the four dreaded words, “We have a problem.” I braced myself and asked, “What's the problem?”

Arnold replied, “There's a snake in the house.”

I asked, “What kind of snake?”

Arnold said, “A big snake, like a boa or python. We found stool samples in the basement and took them to the pet store and that's what they told us.”

Arnold and his wife now wanted their option fee back and said they were going to move out immediately. He asked me, “Wendy, do you know of any snakes in this house?”

I said, “Arnold, hold on just a moment.”

I put him on hold and thought about it for a moment. It began to come back to me that the previous owner, a big burly guy with a lot of tattoos, had snakes. I was a little fuzzy on it, though, because I had only been out to the house once, whereas my office manager, Amie, had done many of the visits to that home. I turned to Amie and asked, “Did the previous owner by any chance have snakes?”

She said, “Oh yes, don’t you remember? He had cages full of them in the basement. And on the day that we went to close and do the walk-through, I noticed that one of the big cages was empty so I asked him where that snake was and he said he gave it away.” We both fell on the floor laughing hysterically. We had never heard of such a thing in all our years of real estate. A big snake loose in a house. Understandably, it was not so funny to the tenant.

We had no idea where to start. We had dealt with leaking roofs, flooded basements, broken furnaces, frozen pipes, anything else, but big snakes? We don't have those in Michigan!

I got back on the phone with Arnold and said, “Well, there's a chance there could be a snake in the house. Let me call the previous owner and see if he knows anything about the snake. I'll call you back.” The previous owner was nowhere to be found.

Do you know how hard it is to find a snake expert in Michigan? I called animal experts, the zoo, pet shops, animal control, and exterminators, but I couldn't get help on the situation. I had my handymen go into the house and crawl through everything, including the attic, in an attempt to find the snake. They could not find one.

In the meantime Arnold called and said someone had gone into the home and seen the snake's tail go up into the wall from the crawl
space in the basement. Arnold also told us he and his wife were moving out. I then received a call from their attorney asking for their option fee back. I discussed it with their attorney and several of my friends, who agreed they would not live with a snake either. I told the attorney that when I found the snake I would gladly return the option fee.

After many more weeks of searching, we finally found a guy whom I nicknamed “Mr. Outback” because he was willing to handle any type of critter situation.

Mr. Outback said, “Look, I’ve got this glue that’s $100 per gallon, and I’m going to put it onto a plywood board and put the board on the basement floor. When the snake crawls across it, he’ll get stuck and we’ll have him!”

I let him put the board down, but, doubting the success of this method, I also called the attorney back and said, “I’ll tell you what: If you can get sworn affidavits from the people who examined the stool samples and from the people who saw the tail go up into the wall, I’ll refund the option fee.”

In the meantime my partner said, “Sell that house.”

The house went back on the market, but I forgot that glue board was in the basement. An agent, Susan, was showing the house. She went into the basement and I had forgotten about the glue board. My cell phone rang as she had stepped onto the glue board. “Wendy? What is my foot stuck to in the basement?”

I said, “Oh, that’s just the glue board to catch the big snake in the house!”

Susan screamed, and I couldn’t stop laughing. I said, “I’ll pay for your shoes!” The house did sell not long afterwards, and I wrote on the seller’s disclosure, where it asks for history of infestation, “None—confirmed.”

I never heard from the attorney or Arnold again.

I think what may have happened in this case is that Arnold and his wife didn’t like the smaller home. When the neighbors told them about the previous owner’s snakes, they began to imagine noises in the walls. Regardless, with no snake there was no refund. I could have gone after the rest of the rental agreement also, but we sold the home, so I dropped the matter. It is amazing what people will do to get out of an agreement.
Property Management Issues

If you have tenants in your home, you have certain responsibilities to them. Take care of the house, make sure it’s livable, keep open lines of communication. View your sellers and tenants as customers. I’m tougher on the tenants because they botch deals more often, and that’s not usually an issue with the sellers, but I still always keep my end of the bargain.

Make sure that you’re keeping your Realtors, lenders, and others informed at all times, and that they know where to reach you if they have questions. Communication is key!

Protecting Your Privacy with Tenants

In general you do not want your tenants to know where you live, so have their rent come to either an office or a post office box. In case a deal goes sour and you have to evict them, you don’t want a disgruntled, grudge-bearing tenant to show up on your doorstep. You have to protect yourself and your family. I don’t give my tenants my home phone, and that number is unlisted. I would only give them my office or cell phone number. Make it difficult for them to find you.

Who Is Responsible for Repairs?

One of the benefits of the lease option is maintenance—the tenant does it all! My lease option contract says that the tenant is responsible for all maintenance, major and minor. However, if I end up having to do any repairs, I’m going to add the cost to the purchase price at clos-

Wendy’s Lesson

Option fees are not refundable, even though some people will try to get them back. They might even make up stories to get their option fees back.
Managing the Property and the Tenant-Buyer

Let them think through their own possibilities first, but if they still don’t know what to do, then send your own maintenance people and recoup the cost at closing.

For example, if the tenant’s heat goes out in the middle of a Michigan winter, it’s crucial to get that fixed. On the other hand, if the air conditioning goes out in the summer, it’s unpleasant but livable. Do not make your tenant unduly fix too much, because if you treat the tenant like an owner then the court may treat you like a seller. The tenant can claim that they’ve put so many dollars into the property, and the court may make you go through a forfeiture or a foreclosure versus an eviction, which in most states is more expensive and much more difficult.

In a buyer’s market you can put more of the responsibility for maintenance onto the seller (see Chapter 6 on negotiations). In a seller’s market, I don’t want my seller to do anything but be free and clear of that issue. However, I have to preapprove in writing any improvements my tenants do.

Keep a copy of any letter regarding maintenance in the tenant’s folder. When a tenant calls, I record what was said for their records also. The same goes for maintenance. I track everything. If the roof leaks, and someone slips and falls, accurate files will suddenly become very important!

Transition between Seller Moving Out and Tenant Moving In

Always assume that the tenant won’t buy. Otherwise it’s like the proverbial counting your chickens before they hatch.

Therefore, always have complete documentation of everything regarding a tenant moving in. Probably your most important thing will be to have a videotaped walk-through check-in with the tenant. It is important that you capture on tape their verbal acknowledgment of the condition of everything, whether good or bad. You also protect yourself with paper documentation of the condition of the house—documentation that they have signed. The tenant always thinks they’re going to buy, but things happen, and a checklist protects both you and them. If the window wasn’t broken at the time of move-in but is when they move out, you will have paper and
STEPS TO SELLING PROPERTIES ON LEASE OPTIONS

Video evidence if you need to take them to court and sue for any damages.

After the seller has moved out, make sure it’s ready for the tenant. This includes the following steps:

- Carpets are cleaned if needed (the seller may do this, but if they don’t, you need to make sure it happens).
- New paint (if needed).
- Dings are fixed.
- Kitchen and bathrooms are cleaned, regROUTed as necessary.
- Kitchen cupboards are cleaned out.
- All appliances left behind are clean and in good working order.

Go through the check-in/checkout sheet with the outgoing tenant—have them check the condition of everything and sign everything. Take pictures at the same time or even videotape the walk-through for future reference if needed.

Keep track of the title during transition, especially if you’re not making the mortgage payment, and especially if it’s a long-term contract. You want to make sure the title stays clean and clear. Review the title work occasionally if you feel there could be something going on with the seller that might negatively affect it.

Maintenance on the Property

Although the option agreement states that the tenant is responsible for all maintenance, it is still important that you keep the place habitable and treat the current resident like a tenant. If you treat them like an owner, a judge might also treat them like an owner, which will nullify the option.

- Always change the locks after a tenant moves out. If you don’t change them and someone still has a key, you could open yourself to serious liability.
- Clean the carpets.
- Repair any paint problems.
Managing the Property and the Tenant-Buyer

When a Good Buyer Turns Bad

Unfortunately, this business is not all perfect. There are times when you will have a tenant that you think is great—you are sure they will exercise their option; they have paid on time, taken care of improvements/repairs, and been nice in all dealings. Then it happens: Either you don’t hear from them (they miss a payment) or they start to make things difficult with repairs, complaints, and so on. They were a good tenant and now they are bad.

I recommend trying to work things out on the phone first. If this does not resolve the situation, then put things in writing. If you have a problem with a tenant that can't be resolved over the phone or in writing, then you must go to the next step: eviction and the revoking of their option. In order for you to be able to do this, they must have violated part of the rental agreement, or option agreement.

This is why I use option contracts that are subject to the rental agreement being followed. I include in my option contract this statement: “If any rental or option payment is made 10 days or more late, then this option can be declared null and void by Optionor.” It is usually advised to revoke an option in writing before you evict a tenant. This adds only one or two days to the process. Once you revoke their option, you can start the eviction, as there is then no option agreement in place. (In most parts of the country, revoking an option agreement is not necessary to evict someone; however, it is the safest way.)

To revoke an option, you can send the tenant a letter via both first class mail and certified mail, both letters containing the information that the option has been revoked. The certified one is the one you want them to receive and sign for, but if they don't, you sent it first class also. I use this for extra precaution. When you send the revocation letter, you should indicate why you are revoking their option. You might want to attach a copy of their option agreement and highlight the area you are utilizing to revoke their option contract. The letter can be as simple as this:

Dear Joe,

Attached is a copy of the option agreement you signed. Your rent is now 15 days overdue and this is a violation of the option agreement. You have been late many other times
also. We are now voiding your option agreement. Please be advised that you no longer have the right to buy this home.

Sincerely,
Wendy Patton, member
Wendy Patton’s LLC

If you want to allow them to reinstate their option, you can state that in this letter:

If you want to reinstate your option, you will need to remit the amount of $__________ currently due, by (date).

I recommend this statement if you want to work it out with the tenants. Remember to try other, softer ways to work it out first; the revocation letter should be a last resort. If this is used too early in the negotiations, the buyer may be angered to the point of no return.

The best advice I can give on late payers is to start eviction as soon as possible. My office starts to evict when rent is five days late. From over 20 years in this business, I can tell you that, unfortunately, tenants lie. I tend to want to believe them and want to work with them. It was always hard for me to evict, because I have a soft heart. I want to believe people and I do until they prove me wrong. Unfortunately, I have been burned many times from deceit and promises that could not be kept. Remembering one thing can help you be firm on this policy:

You can listen to all the sob stories you want; however, most of us can’t afford to carry another family.

If you don’t like playing the heavy, you can also have your partner/spouse sign the contracts and you be “the manager.” The tenant doesn’t know you are the owner also—they only think you manage the
Managing the Property and the Tenant-Buyer

home. This way when they don’t pay and they give you a sob story, you can be the good guy. Example: Tenant hasn’t paid rent due to husband being laid off, wife is pregnant, it is December and very cold outside, and it is almost Christmas. You can say, “Boy, I really feel for you. This must be a hard time for you. I would let you stay, but I have to start to evict you, or I could lose my job. The owner is very strict on this and is tight on cash too. He/she really needs you to pay soon. Do you think you can do it?”

A special note about receiving payments that are postmarked with a Pitney Bowes machine: The dates can be changed, of course. A tenant can tell you, “I sent you the check,” and you may receive it several days late with a Pitney Bowes stamp that precedes the due date. I tell my tenants that their payment has to be stamped by the post office and not a Pitney Bowes machine because of the potential for deceit. When I was first starting out, I didn’t realize that the dates could be changed and I got burned a few times until I realized this.

Of course you don’t want to have late payments from your tenants, so you lay out the ground rules up front about late fees. However, tenants can feel too intimidated to call their landlord with even a legitimate excuse about why the rent is late. It is important, therefore, to keep a rapport with the tenant, so facilitate a comfort zone and open communication. Be friendly but not friends—at least not until the option is exercised. It’s similar to a parent-child relationship—the parent is not the child’s best friend. Being a landlord is a business. If the tenant doesn’t pay the rent and you don’t do anything about it, you will have to pay their rent—and that’s not a smart way to run a business.

If you have an arrangement with your tenants that their rent is always due on the first day of the month and you don’t get it, call them immediately or send a notice: “Is your rent going to be late? Call in with one of these numbers, so we will know why.” When your tenant first moves in, you can give them a list of the most popular excuses you’ve had for rent being late. It’s a little humor but at the same time lets them know you’ve heard it all before and that you’ll be watching. It also shows there is a serious side to paying rent on time. You can add to your own list as you learn through the years. You won’t believe the excuses you will hear.

- I lost my job.
- My dog ate the cash.
My grandmother died.
My grandmother died again.
My roommate stole the money.
My boss didn’t pay me.

If you need to take legal steps to collect past-due amounts, be aware that each state has different collection procedures and abilities. In Michigan I can garnish bank accounts, wages, state tax refunds, and so on. In Texas, landlords can’t garnish anything. You may want to use a collection service, but be aware that the collection company will take 40 to 60 percent of what is recovered.

**Tips to Increase Profits and Protection**

Sometimes it pays off to find the tenants before you find the house! Line up some potential tenant-buyers, then go find the homes that will fit them in their price range and in their area. This is especially a good idea in a buyer’s market.

Clearly define “on time” to your tenants, and charge for late rent. My rental agreements say that I will charge $5 per day, and I enforce that. Also charge court costs, state fees, legal fees, whatever your state will allow you to charge.

I always pay the water bills myself, then bill the clients for them. This way I make sure they are paid on time. Otherwise the city could put a lien on the property if I left it up to the tenant and the tenant didn’t pay. Not all areas of the country are the same, so check this out in your area.
Enforce your maintenance co-pays. If the tenant is supposed to pay the first $50 of maintenance, make sure they do.

When you get a check, call the bank and see if that check is good. The bank won't tell you how much is in the account but they will tell you whether it will clear. If it's not good, call back a few hours later and suggest a lower number, asking if a check for that amount will clear. If the first amount of $1,000 was not good, but the second amount of $800 is good, then you know that the account has between $800 and $1,000 in it. In that case, deposit $200, then cash the $1,000 check, and bill back the tenant for the $200 difference. You must call and make sure the check is good before you try to cash it, because the bank will only submit the check twice. My policy is that tenants may use personal checks until one bounces. Thereafter they all must be certified funds or a cashier's check.

Moving a Tenant Out When They Decide Not to Exercise

If the tenant decides not to buy the property, then go through the property with them and check it out.

If you had a security deposit with the tenant, keep in mind that in most states a security deposit cannot be used to cover normal wear and tear on the property. Normally with an option I don't have a security deposit, because I want their money tied up in the option (nonrefundable) as opposed to a security deposit (refundable), but there is a good argument to have money tied up in a security deposit: Then it looks more like a rental agreement. Of course, if they have animals you might also want to charge a security deposit for that. In any rental agreement, if the security deposit isn't enough to cover damages, you would have to sue the tenant to get recovery for damages.

A Success Story

I lease optioned a property to a real estate attorney's daughter, who wanted her dad to review the contracts. I don't mind at all if an attorney reviews my contracts because I know I'm not going to change
them much. The dad called me and said in a stern voice, “I’m not changing one thing.”

I said something like, “Oh no, the contracts must not be very good.”

He said, “No, you don’t understand. My daughter made her bed and she can lie in it. She got the bad credit herself, and she can fix it. Your contracts are tough but they’re fair. If she doesn’t do her thing, she can lose her money. I’m not bailing her out anymore. I just wanted to make sure they were fair.”

Thankfully, the daughter made her payments and ended up buying the house. I made $35,000 on the deal. I saw the daughter again three years after she had closed on the home. She ran up and hugged me and thanked me for her home. She had recently sold it and made over $40,000 herself. She had two children and needed a larger home. This is a true win-win-win!
This is when it all comes together! This is the real estate investor's payday. If you have been working with your tenant-buyer from the beginning and keeping them in touch with a mortgage broker, you will know when they are ready to purchase your home—they are finally ready to close. If they want to use a mortgage broker of their own choosing, find out who it is and keep in touch with them, so that you will know where they stand on getting their mortgage completed.

Although the paperwork was signed many months earlier, often the mortgage lender may want you to change something on the contracts in order to get the mortgage approved. For example, the buyer may need more money for closing costs, so the lender may ask if you are willing to pay for some closing costs if you increase the price of the home by the same amount. I am always willing to do this, as long as the home can appraise for the new amount and the changes are fair for all parties involved.

I have also been willing to hold a second mortgage for the buyer. For example, let's say the buyer is purchasing the home for $200,000 and they gave me a $4,000 option fee. Therefore they owe me $196,000 (or possibly less with option credits for paying on time, etc.). However, the lender wants them to have 5 percent plus closing costs
into the home, and they don’t have any more money to put down. They need an additional $10,000 to close this home. I might be willing to hold a second mortgage for these buyers for the $10,000 if I believe the home is worth the mortgage and that the people will make their second mortgage payments. I would then get all of my profits out of the home at closing except the $10,000, which I would get out over time with payments on the second mortgage. Many times on the second mortgage I do a one- or two-year balloon so that I get paid off fairly quickly. They would have to refinance the home in that time period and pay me off.

A simultaneous or double closing is when there are two closings on the same home at the same time or on the same day. It is sold and bought the same day. Usually the investor does not need to bring any money to the closing; the money brought in is the tenant-buyer’s mortgage or cash. That money is used to pay off both the owner and the investor, as in the following diagrams.

**Typical Example of How the Deed Flows**

Owner → Investor → Tenant-Buyer

Deeds home → Deeds home → Final deed

**Typical Example of How the Money Flows**

Owner ↔ Investor ↔ Tenant-Buyer

Payoff $ ↔ Payoff $ ↔ Gets mortgage and gets the home

Seller’s equity ↔ Your profit
Closing: The Big Payday

This applies only to lease option deals. (With subject-tos you will already own the home, so there will not be a double closing.) These can be tricky with lenders that require seasoning of title (discussed in Chapter 7). It is essential to show that your interest in the title did not appear overnight. Depending on which state you are working in, closings may be handled by either a title company or an attorney. Some title companies and attorneys don’t like simultaneous closings, due to the fraud in the investing industry that has created the seasoning requirements. Make sure you find a title company or attorney who understands how you do this business and what you are doing. If you want a good reference, your local real estate investor group will certainly know who does this type of closing in your area.

Find out when the buyer is going to close, and stay in communication with the seller about it until you get it down to the exact day and hour. You need to be the coordinator, not anyone else. You have to make sure all the pieces fall into place. Coordinate the tenant’s making arrangements with the mortgage company. Make sure the buyer, the title company or attorney, and the mortgage company are all on the same page. I recommend you reconfirm each party the day before. It would be a shame for the deal to fall through due to a scheduling oversight.

The mortgage lender only sees one half of the transaction—the part between the investor and the buyer. To the lender, I am the seller. The title company sees both parts. Make sure when you are coordinating with the title company or attorney’s office that they know both sides of the transaction, as they will need the paperwork on both sides. To them it is two separate files, and two closings.

The mortgage lender will need copies of the contracts, a payoff letter (see the example at the end of this chapter), and copies of canceled checks. From the beginning, ask the tenant to keep copies of their canceled rent checks, if possible. With the banking industry changing and not sending our checks back, they might have to order these, but I also keep a record of all of their checks—check number and date paid—as a backup. Most lenders, if they want to do a lease option refinance type of program, will need 12 months of canceled checks or proof of payments. A letter from me alone is not enough.

I do not like my buyers and sellers to meet. Though intellectually each of them knows I am making a profit and each of them
knows I am a real estate investor, putting that dollar amount in front of them can destroy their enthusiasm. Each of these real estate deals is structured to be a win for each person involved, but imagine what happens if we change the scenario and put us all at the same closing table. The seller and buyer see me get my check for $42,400, and their joy is greatly diminished. They are not as happy about the deal they each received when they know exactly how much I am getting. The psychology of the room changes. I don't want to change the way they each feel about the deal, and therefore I never put them together.

Although it doesn't really matter who goes first, the one who closes first will have to come back a second time. Let me illustrate why.

Scenario 1: tenant buyer first. The tenant buyer comes in with the mortgage papers completed but cannot receive their completed ownership package, because I don't have the deed yet from the seller. I can sign one to them, but I don't have one yet from the seller to me. They will have to come back and get their closing package after the seller closes with me. This is called a “dry closing,” or “closing in escrow,” meaning that something more has to happen for it to be completed. In this case, the seller's and my closing must take place for it to be completed.

Scenario 2: The seller goes first. The seller can come in and close first with me, but no money changes hands until the closing takes place between me and the buyer. This would also be a dry closing, or closing in escrow. This closing is waiting for funds or money from a mortgage, but not my mortgage—the mortgage of my buyer, which will be completed at the second closing. I am essentially paying cash on this deal, but only when I receive it from selling the property to the tenant-buyer. The seller must come back a second time in order to pick up their check.

I prefer to close with my buyer first so that the money is at the title company or attorney's office. I will usually then call the seller to let them know everything is fine and ready for their closing. Sometimes with mortgage companies the money is not wired into the closing office until hours later or the next day; therefore, the seller might not get their funds until later anyway. I just like to know the money is there and waiting.
Closing: The Big Payday

Here is an example of a payoff letter for the lender:

To Whom It May Concern:
The payoff for 123 XYZ Street is:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>$200,000</td>
</tr>
<tr>
<td>Less option fee paid on (date)</td>
<td>$-5,000</td>
</tr>
<tr>
<td>Additional option credits earned</td>
<td>$-1,100</td>
</tr>
<tr>
<td>Balance due as of (date)</td>
<td>$193,900</td>
</tr>
</tbody>
</table>

Please feel free to call me with any questions.

Sincerely,

Wendy Patton, Member
ABC, LLC
(222) 333-4444

Add anything else if they owe you any repairs during the option period, outstanding utilities, outstanding rent, and so on. Don’t forget to put these in the payoff letter also.
I once bought a parcel of property on a land contract. The property had splittable acres in a town near me, which was fairly rare. One part of the property needed development and the other part had a house. The seller of the house was an older lady who had lived there for 30 years.

Because the house needed some work, I lease optioned it as a handyman special. Along came Steve, who was a licensed builder. Because he was a licensed builder, I had him sign all the contracts under both his personal name and his company name.

When signing contracts, always have the tenant-buyer sign both personally and under their company name, if they have one—especially on the rental agreement. Also have all parties over the age of 18 sign the rental agreement. This puts each person and the companies liable for the debt, if the tenant-buyer does not pay.
For Steve, this seemed like the perfect house. There wasn’t anything in it that needed fixing that he wouldn’t be able to tackle or have the resources with other contractors to tackle. It wasn’t too far into the renovations, however, that Steve called me and said, “We got a problem—this house has been in a fire.”

I was unaware of any fire, so naturally my first response was to call the seller and ask if she knew anything about a fire. The seller confirmed that while she lived there, there had never been a fire. Now because the house was built in the 1920s or 1930s, there was a possibility that anything could have happened to it, but she didn’t know about it and neither did my inspectors. Steve said, “Wendy, I can’t even believe the roof is standing, because all the rafters are completely charred all the way up and through the decking.”

I asked him what it would cost to repair, and he said $3,500 in materials. I offered to give him $3,500 off the purchase price when he exercised the contract. This had been advertised as a handyman special, so I hadn’t cheated him or lied to him. How could I know what was up under the plaster? He agreed and we signed an addendum.

Everything seemed to go smoothly for months—he was making repairs and improvements, and I was sure he was going to exercise. Month 17 came, and I asked him if he’d been speaking to the lender and if he was going to get a mortgage. He said he had a little glitch in his credit, so I asked if he wanted to extend for another six months. I didn’t have a problem with this because he’d been paying perfectly. But he said, “No, I’m moving next month. I don’t like all this development happening around me.”

Steve had known about the development when he moved in, and it was documented in the contracts that he signed. He moved out and sued me for the option money he had put down in the beginning.

Being sued is scary and nerve-wracking for most people. I don’t like it either, but I have been through it a handful of times. It’s inevitable, and all the more reason to keep excellent records on every little thing that happens with each house, each conversation, each mailing, and every document.

In court Steve told the judge that there were many problems with the home, and he showed the judge many pictures of the home and of the fire damage. The judge asked him if he thought I had known about the fire. He responded, “No, I couldn’t tell either, it was covered in plaster.” Then the judge asked me. I said I had not known
and that I did offer to pay the $3,500 to fix it. The judge looked over our contracts very briefly, and noted where it said the home was sold “as is,” that it was a handyman special, and that Steve had had the home inspected. The judge pulled her glasses down to her nose, pointed to a paragraph in my contract, and said to Steve, “Wendy did not have to offer to pay anything for the roof—she was more than fair. So, sir, I have just one question for you. What part of ‘This option fee is NONREFUNDABLE’ do you not understand? Case dismissed.”

Advanced Selling Strategies for Lease Options

Having mastered the basics of lease option deals, you might want to add some of these strategies to your repertoire.

Handyman Specials

Handyman specials are homes that are in less than perfect condition and require sweat equity to bring them up to a new level of respectability. A lot of money can be made in a handyman special. The tenant-buyer's overall purchase price, or option fee required, should be lower because they must do the work themselves. I can't provide enough homes for people who want this situation. This technique will work in most areas of the country except in areas where the city requires certification or landlord licensing. In those areas the city won't allow homes that aren't perfectly up to code to be rented. Sometimes these homes might just need paint or a few minor items, but sometimes they may need some major repairs. In areas where the city doesn't require inspections or certifications, this can be a great way to liquidate your properties. Tenants perceive value in the fact that they can do the sweat equity themselves. You'll make just as much money and you won't have to go over budget on doing your own rehabbing.

One word of caution: Make sure the home is habitable. It must be able to be lived in, or you will have problems if the tenant-buyer doesn't pay and decides to fight you on rent or their option. Any judge will expect the landlord to provide a “habitable” home for their
tenant. Generally the tenant-buyer is going to love you because you are giving them the American dream: a nice fixer-upper.

**Section 8**

Section 8 is a rental-assistance program funded by the federal Housing and Urban Development department (HUD), which gives approved tenants financial assistance by paying a portion of the rent directly to the landlord. Section 8 now has a program for lease options. Section 8 doesn’t control the particulars of how the lease option is set up but will make the monthly payments as with their regular program. After the lease option is started, they will help the tenant-buyer get a mortgage that will convert the lease option to a purchase. It’s not appropriate for every Section 8 tenant but for a select few that qualify. Talk with your local Section 8 administrators so that you have all the current information.

As a landlord, I love Section 8, because the rent payment, or most of it, comes directly to me from the state.

**Ads for Soft Rental Markets**

In soft rental markets there will be many rentals and not many good tenants. In order to get a good tenant into your home, you will need to make your rental ads stand out. The ad must contain something that looks better than the competition’s ads. One idea that I have used is to offer to rent for a few hundred dollars lower than I actually intend to let it rent for. When the applicants come to the home, I screen them to see if they can afford the extra $200 per month. If so, I offer them a chance to make 50 percent on the additional $200.

I might say, “You really like this home, don’t you? And you want to buy it, right?” Of course I know they do. “How would you like to make 50 percent on your money?” When they say yes, then I offer to give them a $300 monthly credit toward buying the home if they pay an extra $200 per month. Now I am getting my $200 more per month, which is what I originally wanted, but I advertised it at $200 per month less to generate the leads. Yes, it does cost me $3,600 in option credits for the entire year if they purchase, but I was able to rent the home. If they don’t purchase the home, I received my entire rental amount. This is a small amount to pay to get someone in during a slow market.
Strategies for Reducing your Taxes

How would you like to have to worry about paying Uncle Sam? Worry about getting into a lower tax bracket because you are making too much money with lease options and subject-tos? When you have been investing for some time and get your pipeline filled with deals, your income will increase and you will need to be creative in finding ways to save on taxes when you sell. You can always keep your properties forever, but if and when you sell, there are tax issues. Here are some things that I have done to reduce taxes for myself.

Exercise Your Option and Hold for Another 12 Months

If you are in a higher tax bracket, you might want to consider exercising your lease options with your sellers prior to your tenant-buyers exercising their options. If you do a simultaneous closing, it is considered a short-term capital gain. You only owned it for one day. Therefore you are taxed at your normal income rate. You can sell your option by assigning it, but if you have held it for more than 12 months it is long-term capital gains, taxed at a much lower rate. Unfortunately, if you assign your option, the profits are not nearly as good as selling it to a tenant-buyer, and very few tenant-buyers can pay an entire assignment fee to get you the profit you would receive if they were to purchase it outright.

Therefore, if taxes or high tax brackets are an issue for you, consider exercising after the 12 months of payments to the seller (treated as a refinance so you don’t have to put down cash out of pocket either—see Chapter 4), and then make sure your tenant buyer doesn’t close for another 12 months. This would give you long-term capital gains on the ownership of the property and give you a much better tax rate on the profit. This is not a problem with subject-tos, as you are the owner from day one and only have to do a lease option for 12 months to get a long-term capital gain rate.

1031 Tax-Deferred Exchange

A 1031 exchange is an excellent way to defer your taxes and capital gains by taking the profit of your sale and rolling into a property of
higher value, or two or more properties whose combined value is higher than your sale. A 1031 tax-deferred exchange is a great tax strategy, but this takes a bit of planning and foresight because there are time limits to make this happen. In other words, at the time of sale you should have a property lined up already into which you can roll the money.

You won’t actually handle the money yourself. A company that does 1031 exchanges will play what is called the intermediary between the current sale and the new property and will move the money from one closing to the next for you. It has to be done very carefully and with a good company or the IRS might not allow the exchange. You can’t touch the money. You also can’t live in the new, higher-valued property or in any of the combined properties that are in total a higher value. You need to rent the properties or hold them as an investment since a 1031 is for investment exchanges and not personal residences.

This strategy should be used when you need to defer your capital gains. When you are first starting out in the business, you might not be showing much income, so you won’t need the 1031 technique, but do remember it exists. When you start needing these techniques, you know you’ve made it!
CREATING FUTURE FINANCIAL FREEDOM—FX3
You might be thinking, “I have a few properties, and keeping track of what’s going on isn’t difficult with some files on my desk.” But apply that thinking to 175 active properties in various stages of buying and selling, renters paying late, evictions, and rehabs, and you’ve got an administrative nightmare if you don’t have systems in place.

**Setting Up an Effective System**

Whether you have only a few properties or many, you might as well set up your business as if you’re planning for many properties. That way you’re already in the groove for expansion.

**Color Coding Your Files**

Have a file cabinet dedicated (or maybe just one of the drawers to start) to your properties. I keep my files in alphabetical order by property address, not by seller or tenant name. Each property has two
files. How you color code your files is up to you, but I use green labels for the seller (think green for money!) and red labels for the tenant-buyer. When I open my file drawers, it's like Christmas! My folders are half-tab, which means the tab goes halfway across the top of the folder. This has been easier for me to deal with, and one color is always on the right and the other color on the left.

**Seller Folder**

![Seller Folder Diagram]

The seller folder holds all the documents that you signed with the seller—the pro-buyer contracts. If you own the property on a subject-to or a mortgage, it would contain all of the mortgage or subject-to documents. It also contains any correspondence with that seller. This folder would also contain any information about the home such as title work that was done, surveys, inspections, etc.

**Tenant-Buyer Folder**

The buyer folder holds all of the pro-seller contracts. It also holds all correspondence with the buyer, original application, credit report, copies of payments, all bills, maintenance records, all other related correspondence, and a 3 1/2-inch floppy disk or CD with digital pictures of the house. This folder may even contain digital film of a walk-through of the property with the tenant to show the condition of the home when they moved in. Keep a copy of each check they write, any water/sewer bills, and other bills that you have sent them. You will need their check copies for when they get their mortgage, to prove that each payment was made and when. They will need to get their cleared copies from the bank, but your copies will help them know what check numbers to request from their bank.
Business Organization for Lease Option and Subject-To Investments

This folder should also be used to keep track of any communications with the tenant. Anytime one of your tenants calls, record the call on a piece of paper, writing down what they said, what you said, and how you handled the call—whether there was anything to be completed. Document everything with the dates and times, and if you send a maintenance person, make a record of who you sent and what they did to fix or not fix the problem. Hopefully, you will never need the documentation, but if you ever do you will have it there. Don’t throw it away until years after you have sold the property to them or to someone else. I had a case where a tenant sued me a year after they moved out for a slip-and-fall case from 2.5 years earlier; however, we had all of our documentation, so it never went to court. Keep your records. I didn’t even know they were upset about it and I would never have expected them to try that, but they did. Tenants have a certain number of years in which they can still come back and sue you, so hope for the best and plan for the worst.

Software for Your Business

If you have only a few properties, you don’t need any special software for keeping track of their information. A simple spreadsheet in Excel will work just fine. However, if you have many properties, you will want to invest in a property management software program. Talk to someone in your real estate investors group or on one of the real estate web sites to see what program will meet your current needs.

There are also many accounting programs available. The one my office uses is Quickbooks. It writes our checks, keeps our accounts balanced, and at the end of the year we get itemized reports per property, per expense account, per LLC, or whatever we want. All the good accounting programs will do this for you. The key is to make sure the software can track items by property so that whenever an item is paid or received, it is linked to a particular property. If you are using the appropriate software and have religiously assigned the payments and deposits, you should be able to quickly see a summary and/or detail of all income, expenses, improvements, and so on by property. In Quickbooks, using “Class Tracking,” with each class being a particular property, you will be able to easily accomplish this.
Another advantage to good bookkeeping records is that your bill with your accountant will actually be lower because so much of their work is already completed.

**Work Orders**

When something goes wrong in a home, or when you have work to be completed, you will need a process to track the work. We purchase work order books with carbon copies from an office supply company. We put the property address on the work order, the tenant’s name and number if it’s occupied, and the problem. We keep one copy for us and we give one to the handyman. The handyman must complete the work order, fill it out with details of what was completed, and then bring it back to us in order to get paid. We then follow up with the tenant, if the house is occupied, to make sure the work was completed. If so, we issue a check to the handyman. We keep a copy of the work order in the tenant file. The repair cost may later be added to the purchase price, depending on the terms of the option contract with the buyer and the extent of the repair. The seller may also be responsible, depending on what was negotiated with them.

**Tenant Payment Ledger**

I set up a tenant payment ledger for each property that is either a rental or an option. Here’s an example of what it will look like:

Your Company Name: ____________ Option Fee: ____________
Address of rental: ________________ NSF:____________________
Tenant Name: ___________________ Lease Dates:______ to_____
Home phone: (buyer) ____________ Water Softener: (amount if applicable) __________
Monthly rent: ___________________ City Water:______________
Other Charges: ___________________ City Sewer:______________
        (if applicable)            
Security Deposit: _______________
Business Organization for Lease Option and Subject-To Investments

The next section of the ledger is the payment history. In the following example, our tenant will have an option fee of $1,500, and their move-in date is November 1, 2XXX. The monthly rent will be $1,095, and there's a quarterly water/sewer bill of $52.50. The “Credit” column is for the tenant payments, the “Debit” column is what the tenant owes, and the “Balance” is the sum of the two.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit (owed)</th>
<th>Credit (paid)</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>11-1-XX</td>
<td>Option fee due</td>
<td>$1,500.00</td>
<td>$1,500.00</td>
<td></td>
</tr>
<tr>
<td>11-1-XX</td>
<td>November rent due</td>
<td>$1,095.00</td>
<td>$2,595.00</td>
<td></td>
</tr>
<tr>
<td>11-1-XX</td>
<td>Option fee payment</td>
<td>$1,500.00</td>
<td>$1,095.00</td>
<td></td>
</tr>
<tr>
<td>11-1-XX</td>
<td>November rent payment</td>
<td>$1,095.00</td>
<td>0.00</td>
<td></td>
</tr>
<tr>
<td>11-10-XX</td>
<td>Water/sewer bill due</td>
<td>$52.50</td>
<td>$52.50</td>
<td></td>
</tr>
<tr>
<td>11-23-XX</td>
<td>Water/sewer bill payment</td>
<td>$52.50</td>
<td>0.00</td>
<td></td>
</tr>
</tbody>
</table>

Using a Tenant List

I have also created a document showing all of the properties I own, the current tenants, their lease option expiration date, and what utilities they are responsible to pay. I include a column for the owner and their address, if I have purchased it on a lease option, and my contract expiration date. This list allows me to know at a glance who should be working on their financing. I can always stay ahead by checking my list on a regular basis and getting my tenants to a mortgage broker several months before their contract expires.
<table>
<thead>
<tr>
<th>Property</th>
<th>Company</th>
<th>Owner info</th>
<th>Contract End</th>
<th>Tenant</th>
<th>Lease End</th>
<th>Rent</th>
<th>Utilities</th>
<th>Misc. Info</th>
</tr>
</thead>
<tbody>
<tr>
<td>123 Flintridge</td>
<td>MR Ltd.</td>
<td>Sally Harris</td>
<td>XX/05/31</td>
<td>John &amp; Jane Smith</td>
<td>XX/03/31</td>
<td>$995</td>
<td>Township</td>
<td>Lease option</td>
</tr>
<tr>
<td>Lake Orion 48359</td>
<td></td>
<td>(234) 222-2343</td>
<td></td>
<td>(333) 333-4444</td>
<td></td>
<td></td>
<td>water/</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Cary &amp; Jen Edwards</td>
<td>XX/03/31</td>
<td>$1,195</td>
<td>sewer</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(222) 342-4444</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(333) 333-4444</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>123 Genoa</td>
<td>MR Ltd.</td>
<td>Joe &amp; Jane Smith</td>
<td>XX/02/28</td>
<td>Leroy DuBois</td>
<td>XX/04/30</td>
<td>$1,595</td>
<td>Sewer/</td>
<td>Lease option</td>
</tr>
<tr>
<td>Clarkston 48346</td>
<td></td>
<td>(222) 342-4444</td>
<td></td>
<td>(333) 333-4444</td>
<td></td>
<td></td>
<td>well</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>123 Hilberg</td>
<td>MR Ltd.</td>
<td>Sally Seller</td>
<td>XX/03/31</td>
<td>Bradford Shue</td>
<td>XX/05/31</td>
<td>$1,795</td>
<td>Township</td>
<td>Lease option</td>
</tr>
<tr>
<td>Oxford 48371</td>
<td></td>
<td>(111) 222-2222</td>
<td></td>
<td>(333) 444-3333</td>
<td></td>
<td></td>
<td>water/</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>sewer</td>
<td></td>
</tr>
<tr>
<td>123 Huntington</td>
<td>Mill Ltd.</td>
<td>June Taylor</td>
<td>XX/07/12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lapeer 48446</td>
<td></td>
<td>123 Bliss Street</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ann Arbor 48123</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(333) 333-4444</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Address</td>
<td>Lender</td>
<td>Bank</td>
<td>Contact Person</td>
<td>Payment Date</td>
<td>Service Type</td>
<td>Lease Type</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>-----------------------</td>
<td>--------------</td>
<td>---------------------------</td>
<td>--------------</td>
<td>-------------</td>
<td>------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>123 Hollywood</td>
<td>Keystone</td>
<td>Fifth Third Bank</td>
<td>Alan &amp; Kim Wayne</td>
<td>XX/05/31</td>
<td>Sewer/Well</td>
<td>Rental</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fenton 48132</td>
<td></td>
<td></td>
<td></td>
<td>(333) 123-4567</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>321 Crescent</td>
<td>Keystone</td>
<td>Bank One</td>
<td>Roger &amp; Sally Smith</td>
<td>XX/05/31</td>
<td>Well, Septic</td>
<td>Rental</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rochester Hills</td>
<td></td>
<td></td>
<td></td>
<td>(333) 123-4567</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>481 Kroft</td>
<td>MR Ltd.</td>
<td>Tom and Kim HomeOwner</td>
<td>Jennifer Gale</td>
<td>XX/05/31</td>
<td>Well, Septic</td>
<td>Lease</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lake Orion 43671</td>
<td></td>
<td></td>
<td></td>
<td>(333) 333-1234</td>
<td></td>
<td>Option</td>
<td></td>
<td></td>
</tr>
<tr>
<td>321 Hope St.</td>
<td>Mill Ltd.</td>
<td>Mark Money</td>
<td>Lucy McGillicutty</td>
<td>0X/07/31</td>
<td>Sewer</td>
<td>Lease</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lake Orion</td>
<td></td>
<td></td>
<td></td>
<td>(333) 123-4678</td>
<td></td>
<td>Option</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Keeping Necessary Documents on Hand

It is extremely important to keep documents in your office that you will be using on a regular basis. Nothing is more annoying than needing a document and finding that you don’t have it. Spending time searching online or going to your local office supply store to get it is a waste of your valuable time. For instance, depending on your state, you can download tenant or legal documents from the state’s web site. Save these documents to your Word program to enable you to pull them up and tailor them as needed. You may want to create a document checklist to make sure that you have what you need; then when your supply gets low you can reorder before you run out.

Good Recordkeeping Is a Must!

In addition to the two folders I’ve mentioned, one more file should be used to store every receipt for each property. There are always expenses that the tenant is not responsible for paying (advertising costs, attorney fees, improvements, etc.). In our office, we use legal size folders or large title company envelopes (free from the title company that we use). Each folder or envelope is labeled with the property address and filed in alphabetical order. Every time an invoice or bill is paid for a particular property, a copy of the invoice is filed under the property address. We note the check number and date paid on each invoice. If the tenant is responsible for reimbursing us, a copy of the invoice is also placed in the tenant file. At year end, these receipt files will contain all documentation needed to substantiate all expenses, improvements, etc. for that particular property.

For those items that cannot be associated with a particular property—for instance, general advertising not tied to a particular property (“We Lease Homes,” “Office Manager Needed,” etc.), postage, office supplies, license fees, or the like—we use a file labeled “General Rentals” and file receipts for those types of expenses in this file.

The last type of file used to document our bookkeeping is a file for each bank account, labeled with the LLC name and “Canceled Checks.” We file all the bank statements and canceled checks for that LLC in that file.

At year end, all files are moved to storage boxes. Each box is labeled with the LLC name and year. Placed in this box are all the files
with the receipts for each property under that LLC, as well as the canceled check/bank statement files for that LLC. This may seem like a lot of paper to store away, and some of it may seem redundant (a copy in the tenant file and a copy in the property receipt file), but if you are ever unfortunate enough to go through an audit, everything you need to support your tax filing is in one box, efficiently organized and easy to retrieve. You hope you will never need them, but there are times you will need a copy of a receipt and you want to be able to locate it quickly. I have been audited twice and my audits both had no changes, because my records were so easy to find and they were very clean. The auditor's first words when arriving to my office and getting a tour of our records was, “Wow, you are very organized!” You don’t want to be audited, but if you are, it’s nice to have someone respond that way.

When to Hire Someone

At some point you will need to hire someone to help in your business. When your business has grown to the point where you are no longer able to handle all the tenants, bookkeeping, or organization necessary to efficiently run your business, or you are so busy handling the little
stuff that you are not spending enough time on the real money-making end of your business, it is time to get help.

The first thing to do is to evaluate your own strengths and weaknesses. Then hire someone to take over your weak areas. If you are great with tenants but lousy at bookkeeping, get a part-time bookkeeper. If you are a lousy organizer, get someone to help with this. Perhaps the only thing you need at first is someone to handle the phones, correspondence, and busywork. If you have hired the right person, their responsibilities will grow as your business grows. The important thing is to stay focused on the most important part of your business, which is finding new properties.

Qualities to Look for in an Office Manager or Property Manager

Of the many qualities you should consider when hiring an office manager or property manager, I have discovered a few that I feel are the most essential. Pick a person who has the qualities that are most important for the job you need accomplished, and the rest of their skills will be bonuses. This individual will be your right-hand person and a key part of your team, so it is crucial that you select the right one. Here are the skills that I have found to be the most important over the years—not necessarily in order of importance:

- **Firm.** There are times when a tenant will try to push the limits with being late on rent. You want your assistant to be firm.
- **Pleasant.** Your assistant must be pleasant even when you want to blow up. There are times when I have wanted to lose my temper with someone on the phone, but my assistant will not blow up because she is not personally involved, so she can be nonemotional and pleasant.
- **Detailed.** This person must be able to be very detailed. They will be tracking tenants’ rent, late fees, water bills, option fees, correspondence, and many other items. Everything must be documented and detailed.
- **Good follow-through.** This area is very important, as the little details that fall through the cracks can cost you tens of thousands of dollars and many lawsuits. Making sure that nothing
Business Organization for Lease Option and Subject-To Investments

falls through the cracks is critical; for example, did the gas get turned on at your vacant home in January in the Michigan area? If not, you might have an ice skating rink in your home. How do I know? I had some follow-through problems.

- **Organized.** Following the systems you have in place and your checklists will be very important. Also, knowing that your assistant has things well organized, labeled, and filed, so that you can easily find things when you need them, will be very important to you.

- **Computer skills.** It is impossible anymore to not be involved with or able to use computers, so make sure your assistant has computer skills. Basic word processing and spreadsheets are usually the most important parts of property management. Spreadsheets can be taught, but word processing is a must.

- **Take initiative/work independently.** Your assistant must be a self-starter. They must know what to do when you are on the road. You will be in and out of the office much of the time, or you will want the ability to be. Make sure you hire someone capable of running things if you are out of town. Can they handle calls? Make decisions? Make good judgment calls? Will they work when you are not there watching them?

Some of my best part-time employees are women who didn't need their jobs; they wanted their jobs. This makes a huge difference in the way they perform at work. When someone needs to work, you would think that would be enough motivation; however, if they are not self-motivated it is not enough to keep them doing their best every day. If someone wants to work, that is enough motivation. This is just a guideline—I have also had several full-time employees who did need their jobs who were fantastic workers also.

Wendy's Advice

If you are hiring someone part time, you might want to consider someone who doesn't need a job but, rather, someone who wants a job.
I am excited to share my action plan with you, as this is the number one problem for those wanting to get into real estate but are not sure where to begin. Figuring out where to take that first step the day after attending an exciting seminar can be overwhelming. Many people will buy a real estate investing course and then not know what to do next, so they do nothing. They have wasted time and money learning about tools that can yield them much income, but they don’t use them.

I have asked many other speakers/educators and students around the country about this problem. “Where do I begin? How do I get started? What exactly do I do to implement the course I purchased?” Most courses assume you understand how to get started and what to do next, but the reality is that most people don’t. You are not alone.

The action plan outlined here will guide you to success. If you
Where to Go from Here: A Step-by-Step Action Plan

want to make more money than the ad indicates, then do more of each task. If making half that amount is fine, then do one-half of the task plan. Tailor the plan to your needs and your abilities. If you work full-time, 10 hours may be all you can do. If you are investing full time, I suggest you beef it up and do more, or add additional strategies (rehabbing, wholesaling, foreclosures, etc.).

Sacrifice is essential in any successful venture. Are you willing to sacrifice something to build wealth? If not, then don’t expect to gain financially. Many people wish they could make money, yet they won’t do what it takes. These are the same people who continue to believe they will someday win big in the lottery. They want the money thrown in their lap.

I have made many sacrifices over the years. When I first started to invest in real estate in 1985, I was 21 years old. I owned several rental properties. My friends would go out on the weekend and party. I, on the other hand, would spend my weekends painting, cleaning, driving by my homes, looking at new ones, sending letters, and so on. I was building wealth for the future while they were spending theirs. Many nights I would eat popcorn for dinner, when I had spent my paycheck on paint for one of my homes. I learned to be a frugal shopper, use coupons, keep my heat low—all to save money and build for the future. Today I still sacrifice. I watch little to no TV. I don’t have time. I travel many times on weekends or do late evening meetings or conference calls. This means time away from my family, and they realize that building for the future affects them too. We all work together for it.

A friend of mine told me a story recently. He said his father was the ultimate story of sacrifice. He had a 3,000-square-foot home in an area that is very nice—home values average approximately $300,000 or more. He was single and had several rental homes, and his sons were all grown and living on their own. He really didn’t need much, so he decided to rent out his own home and rent a room from someone else. He could then use the extra cash flow to buy additional homes with his sons and get them started in the business. One night the home he was living in burned down, and he was killed in the fire. Everyone in the house got out but him. It was a horrible tragedy, but his son told me the story of this ultimate sacrifice his father had made for the future. The son is now a motivational speaker and invests full-time in real estate. The sacrifices we make, make us!
This action plan should become part of the goals you have set for yourself. It assumes you have already purchased my course and are planning on buying and selling using primarily lease options as an entrance and exit strategy for real estate investing. You will need to sprinkle some subject-to tasks throughout to add that strategy as well.

The action plan goal is to earn $120,000 in one year with 10 hours of work per week. This plan assumes no vacations. To take a vacation you must sacrifice—that means putting in an extra 10 hours the week before or the week after. I prefer before, so that you don’t get behind in your plan. This plan is meant to be modified and customized to your preferences. For instance, if you find working with Realtors is something you don’t like at all, you might want to work more on other areas and develop those in more detail than I have outlined. Also, once you get a personal system going, you can scrap this plan. Use your own system if you find something that works better for you and your personality.

I recommend you attend my intensive three- to four-day boot camp. This boot camp will walk you through many of these steps and give you a huge head start. Check my web site (www.wendy patton.com) for details about the next boot camp.

The Action Plan

This action plan will be a week-by-week plan for 12 weeks (around 90 days), then month-by-month thereafter.
**Where to Go from Here: A Step-by-Step Action Plan**

**Week 1: Getting Started**

The following seven steps will help you get your system up and running.

1. **Get office supplies set up.** I assume you have a computer, printer, copier, fax, Microsoft Word, and Microsoft PowerPoint (or access to those items), as well as basic supplies like a stapler, scissors, paperclips, notebooks. I recommend that you purchase the legal size file folders with half tabs, alternating left and right. I use right-tabbed folders for my tenant-buyers, and I mark them with a 1/8-inch red line across the top part of the tab. I use the left-tabbed folders for my owners/sellers, and I mark them with a green line across the top part of the tab (green for money). Each property you acquire will have two folders, one red and one green.

   ![Folder Example](image)

   Anything that is between me and the owner goes in the green folder; anything between me and the tenant goes in the red folder. The same property address is on each tab, just on opposite sides with different colors. If a tenant moves out of a home and doesn’t buy, I move their papers out and the new tenant’s in. I keep the old ones for a couple of years—you can mark them by name or address, your choice. If they end up owing me money, the folder goes in a different drawer, but that’s a separate discussion.

   Each of the folders will also be equipped with the checklist for buying and selling. This way you are sure to get everything you need in each folder. In all real estate, documentation is key. If I have a conversation with a tenant, I put notes about it in the folder—handwritten or typed is fine. Keep everything documented and filed.

   Set up some Realtor folders also, one for strong listing agents and one for agents who need follow-up. Keep any potential agents in
the strong agent folder. Print the listings from homes magazines or
when an agent is published in the local paper for being the top listing
agent. In the follow-up folder put copies of your letters in order of
when they were mailed. You will then be able to see when you should
send a second letter out.

You will also need a week-to-week calendar to follow this plan.
Put all action items in the calendar as well as any follow up items. For
instance, if you have to call a seller or Realtor back in 30 days, put it
on the calendar.

You will need some accounting software, such as Quickbooks, or
a ledger to track all financial transactions for this business.

2. Join Pre-Paid Legal. Pre-Paid Legal will cost you up to
$25/month (some states vary with plans and costs) and will be one
of your best investments. You will have access to a law firm in your
state that is top-notch. You can use this firm to ask any questions
you like, review personal documents, draft your will, review your
LLC documents, get legal advice, fight moving traffic violations, de-
fend you if you are personally sued, and much more. For most
states you can sign up on my web site: www.prepaidlegal.com
/hub/wendypatton. See the web site for what is offered in your state.

If you are in a state which will not allow you to sign up on this
site, e-mail me or call my office to find out how to sign up. I will be
able to help you in some way in any state. (Contact me through
www.WendyPatton.com.)

3. Get your LLC (limited liability company) set up in your state.
Get advice from Pre-Paid Legal to confirm whether the LLC is the
best for your situation. Also, find out where in your state to get your
name reserved. Once the name is reserved you can use my forms to
fill out the operating agreement. Pre-Paid Legal will review one busi-
ess document per year, unless you have the business rider (which al-

dows many more but is only available in some states). Have them
review it after you have filled it out.

4. Join a local Real Estate Investors Association (REIA) group.
Join a local real estate investors group in your area, if you are not al-
ready a member. Be religious about attending meetings. Network, at-
tend one-day seminars that are priced reasonably, and start to get
involved in the group by volunteering for group functions. You will
soon be voted onto the board, if you want. Just don’t overvolunteer—
your time is limited! If you do too much for the group, you will lose
focus on your own objectives. If they have a library, check out as
many books and tapes as you can on topics related to optioning: land-
lording techniques, options, subject-tos, and possibly rehabbing.
These show up later in this action plan, so don’t check out too many
up front—it could overwhelm you.

5. Start your Realtor network. Contact any Realtors you know
and discuss with them on the phone what you are now doing. Use my
Live Realtor Call CD or the Working the Realtor System CD to under-
stand how to explain it to them. Also review the PowerPoint presenta-
tion(s) and the script of what to say and how to explain this technique
to Realtors.

6. Read the “for rent” ads in your local newspaper. This is for two
reasons: First, you will find out about your competition, and you will
start to learn your rental comparables. Following your local paper
will allow you to get a feel for the market. Second, call on 10 ads.
Practice. If you get a lead, follow up on it.

7. Create a credibility kit. I strongly suggest that you start build-
ing a credibility kit if you don’t already have one. Although nothing
might be in it yet, you will start to fill it soon with pictures of your
homes and letters from sellers, Realtors, or possibly tenants.

Week 2

Now that your basic system is in place, here are seven more steps to
take you toward setting your business in motion.

1. Realtor follow-up. Review “for sale” ads in the paper. Who has
several listings? Check out the homes magazines. Who has listings
near the area you want to purchase in? Call three Realtors to discuss
what you do over the phone. Ask them about any of their current list-
ings. Ask whether any of their sellers have said to them that if their
home doesn’t sell soon, they might have to rent it. See if they would
like you to send them more information. Send three letters to Real-
tors using the letters in my course. Put these letters in the follow-up
folder for four to five weeks from now. You will need to send a second
letter at a future date.

2. Read a book on real estate investing. I recommend a book on
lease options or subject-tos. Get some other perspectives. Search on
3. **Set your goals.** Review my goal-setting course. Listen to the CD (one hour) and spend two hours working on your goals and mission statement. Setting goals is essential to what you want to accomplish. This action plan should give you a tremendous start on accomplishing the tasks and on outlining the tasks themselves.

4. **Get an accountability partner.** Find a friend in your local group—or a friend who is also committed to goals. They might be in a different field, but if they are willing to commit to meeting monthly and will hold you accountable on your goals and you on theirs, do it. Be religious about meeting with them monthly to discuss where you are on your goals. In your first meeting each of you will share your goals with the other. You must understand each other's goals so you can assist each other in accomplishment and accountability. If this person won't be comfortable telling you feedback on what you are attempting and on how you are doing, then find someone else. You need someone who is sharp enough to give solid input and tough enough to push you. It will change your life and theirs.

5. **Become licensed or get a Realtor on your team.** This will give you access to the comparables in your area. If you are licensed, then you are set. If not, consider it. Evaluate the pros and cons I have outlined in “Working the Realtor System.” I highly recommend it! If you are not licensed, you will need to pay a Realtor to help you out or find a web site that will give you enough information to be able to make informed offers. Find a Realtor who is willing to do comps for you—they might be in your real estate group or they might be a friend. You might need to pay them to help you, but only when you are ready to negotiate an offer.

6. **Create five proposals.** Try different offers. On the proposal, try putting together cash-out offers (if you can follow through), lease option, seller financing, or a combination. Put the proposals away to be followed up on later.

7. **Start to build your team.** Meet with a mortgage broker. Find one (or two) who can work with option buyers and with you. Get each of your buyers in to see this person as soon as they move into their home, and have the broker set up a step-by-step plan for each buyer to follow. Get a recommendation on a title company from
them, if you don’t already have one. They will know who to work with. If you are not sure where to start with a lender, ask your local investor group.

**Weeks 3 through 12**
For the next several weeks you will further develop the pieces you have already initiated.

**Week 3**
- Realtor follow-up. Send three new letters to Realtors using the letter in my course. Put these letters in the follow-up folder for four to five weeks from now, at which time you will send out the second letter. Call one broker in your area to see if you can set up a time to come to their office meeting. Maybe a Realtor friend can work with you to get you into their office. Ideally they should introduce you at their meeting. If you don’t want to speak directly to a group, set up an appointment to meet one-on-one with a Realtor.
- Finish goal-setting. Spend another two hours doing soul-searching in a quiet spot and finish your goals. You will review these goals monthly or weekly, depending on how developed you feel they are.
- Read ads. Read the “for rent” ads and call for one to two hours. Follow up on all that seem like good leads. Get in to see as many as you can. Although you may feel many aren’t going to work out, it is still worth your time to check them out and practice. Learning how to negotiate and what to look for will be critical.
- Create five proposals.

**Week 4**
- Realtor follow-up.
- Listen to a real estate course. As you drive to and from work, listen to a taped course on real estate investing on the topics of lease optioning, landlord techniques, options, subject tos, and possibly rehabbing. Make it something that ties in
CREATING FUTURE FINANCIAL FREEDOM—FX3

with what you’re doing or you will start to get distracted in too many directions. The more we learn, the more deals we will find, because the more opportunities we will recognize.

Week 5
■ Create five proposals.

Week 6
■ Realtor follow-up. Send the follow-up letter to all of the Realtors who received the original letter four weeks ago. If a Realtor said there was no interest for that seller, then send the same Realtor a note on a different listing. Also send letters to three new Realtors.
■ Meet with your goal accountability partner.

Week 7
■ Create five proposals.
■ Review your goals. Update or rewrite them as appropriate. Make sure you are on track.

Week 8
■ Realtor follow-up.

Week 9
■ Listen to a real estate course.
■ Create five proposals.

Week 10
■ Realtor follow-up.
■ Meet with goal accountability partner.

Week 11
■ Read a book on real estate investing. I recommend a book on landlording basics. Learn what you can. Search for one on Amazon.com or check one out from your club’s library.
■ Create five proposals.
Where to Go from Here: A Step-by-Step Action Plan

Week 12
- Realtor follow-up.
- Review goals. Review, update, and rewrite your goals as appropriate.

Months 4 through 12
By now you have a good feel for what to do and how to keep your business moving and growing. We’ll switch now from weekly to monthly tasks.

Month 4
- Realtor follow-up.
- Listen to a real estate course. Listen to another course or set of tapes/CDs on topics related to lease optioning, landlord techniques, options, subject-tos, or rehabbing.
- Review goals. Review your goals and update them as appropriate. Make sure you are on track. Rewrite or update your goals that need to be updated.
- Attend your local REIA meeting. Make this a monthly priority.
- Meet with your goal accountability partner.
- Create 10 proposals. I recommend 10 if you have not secured enough deals in the previous months. Otherwise, adjust the figure accordingly.

Month 5
- Realtor follow-up.
- Review goals.
- Listen to a real estate course.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Again, adjust this figure as appropriate for your current situation.
CREATING FUTURE FINANCIAL FREEDOM—FX3

Month 6
- Listen to a real estate course.
- Review goals.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Realtor follow-up.
- Attend REIA meeting.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 7
- Realtor follow-up.
- Review goals.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 8
- Listen to a real estate course.
- Review goals.
- Realtor follow-up.
- Read a book on real estate investing. I recommend a book on rehabbing.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 9
- Realtor follow-up.
- Review goals.
Where to Go from Here: A Step-by-Step Action Plan

- Real estate course.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 10
- Realtor follow-up.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 11
- Realtor follow-up.
- Listen to a real estate course.
- Attend your local REIA meeting.
- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Month 12
- Open Up a Roth IRA. Choose a self-directed IRA management company. Equity Trust in Ohio is a great company. Put in $3,000 (or maximum allowed). This will be the start of year two for you. You will want to purchase a home on an option during year two using your Roth IRA, and one home per year thereafter in your Roth. This will set you up for the future and retirement. You will soon not qualify for a Roth contribution (you will make too much money). Set it up while you can.
- Realtor follow-up.
- Review goals. You made it through year one. Set your goals now for another year. If you can set them for three to five years, do that.
- Attend your local REIA meeting.
CREATING FUTURE FINANCIAL FREEDOM—FX3

- Meet with your goal accountability partner.
- Create 10 proposals. Adjust the number to fit your current situation.

Each month you will want to follow up with any proposals that are still a possibility. Also, call and continue to build relationships with Realtors who are open-minded and are willing to work with you. This business is one day at a time to build your Future Financial Freedom (FX3).

Wendy’s Big-Picture Advice for Lease Options and Subject-Tos

- Don’t assume the economy will always remain strong. (For the first 15 years I invested, I didn’t know anything different than a seller’s market. We always had appreciation, everything was hot.)
- Pace yourself (in money and time), so you don’t burn out. Buying too many properties too fast can leave you with too much to handle, too many credit cards, and too much debt. Figure out how many houses you can handle based on your current circumstances. Control your growth.
- Be careful choosing homes. Eventually you will have more homes than you will be able to handle. Cherry-pick your deals. Don’t get sloppy. Continue to evaluate each deal on its own.
- Find the good tenant buyers.
- Practice good management techniques.
- Don’t let anyone tell you that you can’t do it!
- Cash the checks and live happily ever after!
Below are some terms and definitions for real estate investors. These are Wendy Patton’s definitions—not Webster’s.

1031 exchange an IRS section that allows a person to exchange their like kind property for another property, of equal or greater value, and therefore defer (not avoid) the capital gains on the first property.

CMA Comparative Market Analysis.

dealer status A “Dealer” status makes what you do as a real estate investor, in the eyes of the IRS, self-employment income (which is much worse for taxation rates) versus ordinary income. The IRS can assume that you are not investing but just dealing property. One way this happens is with multiple rapid buys and sells during a short period of time. This is not something to worry about unless you are really doing a tremendous amount of volume in one entity (i.e., LLC). If you are doing various types of investing, at least keep the types separated into different entities (i.e. all rentals together, all lease options together, all rehabs, etc.). Talk to your tax advisor to get more information, but please don’t get paranoid on this. Just do the business and make money.

double dip Realtors usually divide commissions 50/50: 50 percent to the agent who works with the seller (the listing agent) and 50 percent to the agent who works with the buyer (the buyer’s agent). A double dip is when a Realtor is able to work with both the buyer and seller and collect the entire commission.

due on sale a clause in most mortgages that says if the owner sells the property or conveys interest in it to anyone, the bank can call the
entire mortgage due immediately. It is rare that this happens, but both lease options and subject-tos can violate due on sale clauses by passing along an interest in the property.

earnest money money given in good faith by a purchaser of a home; a deposit to purchase a home. Applied to the purchase price at closing or forfeited if the purchaser backs out.

escrow (1) Escrow accounts are non–interest bearing bank accounts in which you can deposit earnest money received on a property.

(2) Escrow can also be a way of closing on a property. To “close in escrow” means that the title company or attorney prepares all the paper work but does not release any of the originals to anyone until something else happens (i.e., another deed is brought in to the title company and shown, another $200 is received from the buyer, etc.).

foreclosure When someone owns a home and they can’t pay the mortgage payments, the bank will “foreclose” on the home, taking it back from the owner. In some states the owner would have a redemption period after the foreclosure or sheriff’s sale. In most states there is no redemption time. The redemption time gives the owner time to “redeem” the title of their property, but they must pay the entire balance in full in order to redeem. Most owners can’t do this without selling to another person or investor. Once foreclosure is started on a seller, only a few lenders will refinance the property for the seller.

FSBO (pronounced FIZZ-bo) an acronym for “for sale by owner,” referring to properties that are sold without a Realtor, but by the owner individually.

land contract a contract for deed. In a land contract situation the seller usually owns the property free and clear. The seller in effect becomes the bank and only gives up the deed when the buyer’s contract is paid in full. For a buyer, a land contract is better than a lease option because it says that if you make all the payments you get the deed. A land contract is not as strong when you are selling. The reason I don’t like land contracts is that they are concrete sales
rather than a lease. A land contract violates the due on sale clause, although it will probably never get a loan called, and it requires a foreclosure or forfeiture procedure if the buyer doesn’t pay. If you go through a foreclosure or forfeiture, usually you will get only the home back, and not receive any money judgments. It can take months.

**land trust** a way to hold title to a home that camouflages the ownership. This is not an asset protection tool, but tied in with LLCs it can be very effective in asset protection and camouflage. This is used primarily so that no one will know the real identity of the owner. It is also used many times to avoid due on sale, seasoning, and the like. Many investors use this technique to hold properties. It works like a company and can be named as simply as “Joe Smith’s Land Trust.” You can deed your property into it and thereby prevent the due on sales. Liens can’t be attached to it. I don’t use it with my sellers because most of them would find it scary and confusing, but it’s an absolutely legitimate way to operate.

**lease option** A lease option is like a rent-to-own. You have the right to purchase the property, but you are leasing it in the meantime. In a lease option, the seller is obligated to sell, but the buyer is not obligated to buy. An option gives an optionee a right to exercise a privilege. In a lease option it is the right to lease and also the right to purchase a piece of real property—real estate. A lease option involves gaining control of a property but not ownership—just the right to possess a property now and purchase that property at some future date with terms you define today. With a lease option you can get 5 to 10 percent above the retail value of the property just by offering special terms.

**lease purchase** This is similar to a lease option, but a lease purchase has no option. Technically the buyer is guaranteeing the purchase of the home. Lease purchases work well only when the buyer is actually able to make this guarantee.

**Memorandum of Option** a document that records the optionee’s interest in the property. It prevents the seller from selling the home or
refinancing during the option period. It also starts the optionee’s sea-
soning of title.

**MLS** Multiple Listing Service—a database and computer system
which has all of the homes listed by Realtors. In most states only li-
censed Realtors can access this data.

**option** An option gives an optionee a right to exercise a privilege. It
gives the optionee the right or privilege to buy, within a given time pe-
riod, for a given price. Options are used heavily in real estate, but
most options are used in commercial real estate (i.e., you option a
piece of property on the corner of two busy highways, then find a
buyer, like Walmart, to come and develop it. That is when you would
exercise your option. If you don’t find a buyer, then you wouldn’t exer-
cise your option).

**performance mortgage** A performance mortgage is similar to a
regular mortgage on the seller’s property to guarantee that they
will sell you the property. It gives you a lien/mortgage on the prop-
erty, but only on a dollar figure if they don’t perform and sell the
home to you. It’s only based on performance. It puts you on title,
so if their first mortgage goes into foreclosure, you would be noti-
fied because you are a mortgage holder.

**PITI** principal, interest, taxes, and insurance—a full mortgage
payment.

**PI** principal and interest payment. Taxes and insurance are paid by
the owner directly.

**PMI** private mortgage insurance. This is usually required on all
mortgages that have less than 20 percent down. It is normally a
monthly payment added to the mortgage payment, insuring that part
of the loan (the part that is greater than 80 percent of the original pur-
chase price) for the lender.

**rehabbing** Rehabbing a property is when a person buys a fixer-
upper and renovates it, making the property look new and beautiful.
Each level of rehab is determined by the investor and price range of
the home. A rehabber would not rehab a million-dollar home the same way they would rehab a $15,000 home.

**retail value** one hundred percent of market value—the price at which Realtors list and sell homes.

**sandwich lease option** A sandwich lease option is where you have a lease option with the seller and you sell the home on a lease option to another buyer. You are in the middle.

**seasoning** the time between when an investor buys a property and turns it around to sell it for a profit. Seasoning starts when you record the deed or the Memorandum of Option. When you get an option from the seller, record the Memorandum immediately so that the seasoning can begin. Wherever you record a deed, hand-carry it to the courthouse immediately. Never put it in the mail.

**seller financing** When the seller owns a property with no existing mortgage on it—free and clear—they can sell the property to a buyer and hold the mortgage on the property themselves, rather than using a bank or other lender. This will work when the seller wants a good interest rate or when the buyer can’t qualify for a mortgage yet but has a good down payment.

**seller holdback** typically a second mortgage on a home the seller is selling. The buyer gets a mortgage for most of the sales price, then the seller holds a second mortgage for the balance or some portion remaining. This is another type of seller financing.

**short sale** When a bank is owed a certain amount of money on a home, but the owner is going into or is already in foreclosure, shorting means the bank will accept a significant discount on the mortgage balance to get rid of their deal that isn’t performing. Banks do not like bad loans. They are in the business of lending, not of owning real estate. They want bad debts off of their books, and quickly, so they can make new loans.

**subject-to** A subject-to deal is when the seller deeds the property to a buyer, subject to the existing mortgage. The buyer makes the

---

**Glossary**

the home. A rehabber would not rehab a million-dollar home the same way they would rehab a $15,000 home.

**retail value** one hundred percent of market value—the price at which Realtors list and sell homes.

**sandwich lease option** A sandwich lease option is where you have a lease option with the seller and you sell the home on a lease option to another buyer. You are in the middle.

**seasoning** the time between when an investor buys a property and turns it around to sell it for a profit. Seasoning starts when you record the deed or the Memorandum of Option. When you get an option from the seller, record the Memorandum immediately so that the seasoning can begin. Wherever you record a deed, hand-carry it to the courthouse immediately. Never put it in the mail.

**seller financing** When the seller owns a property with no existing mortgage on it—free and clear—they can sell the property to a buyer and hold the mortgage on the property themselves, rather than using a bank or other lender. This will work when the seller wants a good interest rate or when the buyer can’t qualify for a mortgage yet but has a good down payment.

**seller holdback** typically a second mortgage on a home the seller is selling. The buyer gets a mortgage for most of the sales price, then the seller holds a second mortgage for the balance or some portion remaining. This is another type of seller financing.

**short sale** When a bank is owed a certain amount of money on a home, but the owner is going into or is already in foreclosure, shorting means the bank will accept a significant discount on the mortgage balance to get rid of their deal that isn’t performing. Banks do not like bad loans. They are in the business of lending, not of owning real estate. They want bad debts off of their books, and quickly, so they can make new loans.

**subject-to** A subject-to deal is when the seller deeds the property to a buyer, subject to the existing mortgage. The buyer makes the
mortgage payments on the old loan but does not get a mortgage themselves to acquire this home. The seller transfers the title but keeps the existing financing in place; therefore, they don’t own it, but they are still liable for the existing mortgage if the buyer doesn’t make the payments. It stays on the seller’s credit report. This is great when the seller is in trouble or wants out very badly. Many sellers will deed you the property, but usually only when (1) they are uneducated about what it really means, (2) they trust you very much to pay their mortgage, or (3) they are in financial trouble and need to get out from under it immediately. This scenario can help a seller improve their credit, when you pay the payments on time, especially if they were in foreclosure before you took over the title and payments.

**title insurance** insurance insuring the clear ownership and title for the new owner.
Wendy Patton: www.WendyPatton.com
Pre-Paid Legal: www.prepaidlegal.com/hub/wendypatton
Fair Housing Act: www.usdoj.gov/crt/housing/title8.htm
NAR (National Association of Realtors): http://Realtor.org
National Real Estate Investors Association: www.nationalreia.com
Neighborhood Scout (subscriber-based service for finding neighborhood appreciation rates): www.neighborhoodscout.com/
Property Buying Tours (hot market buying trips), www.PropertyBuyingTours.com
Real Estate Seminars: www.FortuneMakersSeminars.com
Realty Times (for news and appreciation rates): http://realtytimes.com/
Rental listings: www.rent.com
RentRight property management software (they have a free trial that you can download): www.rent-right.com
Abatement, lead-based paint, 102, 182
Accountability partner, 238, 240–243
Accountant, functions of, 130, 224
Action plan:
  defined, 234
  goal of, 234
  importance of, 232–234
  initial 12 weeks, 235–241
  months 4 through 12, 241–244
Advertisements/advertising:
  attracting tenant-buyers, 163–165
  cancellation of, 180
  expenditures, 228
  guidelines for, 40, 102
  information resources, 237, 239
  in newspaper, 34
  sample, 35–36
  soft rental markets, 215
  subject-to deal, 115
  tear-off flyers, 34
Affidavit of Liens, 101, 114
Alterations, responsibility for, 188–189
Appliances, 189, 200
Application review:
  components of, 169–172
  rejected applications, 172–173
Appraiser, functions of, 90, 175
Appreciation/appreciation rates, 64, 72–73, 154, 175
"As is" sale, 180, 192
Assessments, 192
Assignment, 188
Attorney(s):
  fees, 190
  functions of, 48, 88, 91, 108, 121, 130, 182, 184, 187, 192, 209
  Pre-Paid Legal, 182, 236
Audits, 229
Back end, 16
Back taxes, 74
Bad credit, with reason, 166–167
Bad debt, 32, 36, 45, 171
Bad tenants, characteristics of, 170
Balloon payments, 208
Bandit signs, 33–34
Bank account files, 228
Bank Authorization, 101, 114
Bankruptcies, 167, 171
Bathroom maintenance, 200
Beneficial owner, land trust, 48
Beneficiaries, land trust, 123–124
Bill of Sale, 114
Body language, importance of, 79
Bookkeeping records, 223–224
Books, as information resource, 239–240, 242
Budgeting, importance of, 16
Burn out, 244
Business cards, 37, 144
Business organization guidelines:
  documentation, generally, 228
  file system, 221–223, 235–236
  hiring employees, 229–231
  office supplies, 235–236
  recordkeeping system, 223, 228–229
INDEX

Business organization guidelines (Continued)
software, 223–224
tenant list, 225–228
tenant payment ledger, 224–225
work orders, 224
Buyer(s), see Tenant-buyer
first-time, 25
good, see Good buyers
objections of, 173–174
Buyer’s agent, 137
Buyer’s market:
characteristics of, 32–33, 81, 136–137
deal structure, 154–155
lease options, 152
Buying signals, 85
Capital gains, 57, 129–130, 216
Carpet cleaning, 191, 200
Cash flow, 16
Certified public accountant (CPA),
functions of, 130
Chamber of commerce, as information
resource, 38
Check(s):
bounced, 186–187
copies of, 176, 181, 222
funds verification, 205
Check-in/out list, 179–180, 193, 200
Cleaning fees, 186
Closing:
characteristics of, generally, 87
costs, 89, 207–208
deed flow, 208
documentation, 209
lease option deals, 209
money flow, 208
subject-to deals, 209
timing of, 210–211
Color-coded files, 97, 112, 221–222
Commission, Realtor, 68, 88–89,
136–138, 150–155
Commitment for title, 97, 112
Communications:
documentation of, 223
with Realtors, 34, 239
Comparables, 72, 81, 88, 90
Contracts:
characteristics of, 80, 82–83, 87
clauses, types of, 107–109, 117–118,
121–123
drafting guidelines, 179
performance mortgage, 121–123
purchase and sale agreement, 93
subject-to deals, 117–118
Control:
without ownership, 52
of property, 183
Corporate relocation departments, 38
Cosigner(s), 185
Creativity, importance of, 26–28
Credibility kit, 237
Credit card debt, 171
Credit check, 46, 52–53, 168
Credit report, 168, 171, 173
Credit score, 171
Credit situations, types of, 166–169
Criminal background check, 171
Damages/damaged property:
collection for, 179–180
protection from, 179
security deposit, 93, 174, 186, 205
Deadbeats, 166–167
Deal structure:
building rapport, 76–79
components of, 155–158
proposal/offer, 79–83
time frame, 130–132
timing of, 62–63
Death, contract provisions for, 87
Deed:
characteristics of, 45, 47, 56, 58–59,
89
in escrow, 121
flow, 208
refinance, 57
transfer, 49, 50–51
Default, landlord remedies, 190
Delinquent taxes, 54
Department of Housing and Urban
Development (HUD), 102, 215
Deposit, nonrefundable, 178, 180,
193
Depreciation, 154
Desperate and distressed sellers, 32
Digital photos of property, 179
Disabilities, economic impact of,
167
Discrimination issues, 87–88
Distressed sellers, 17, 32, 58
Divorce sale, 27–28, 45, 167
Index

Documentation:
Affidavit of Liens, 101, 114
Bank Authorization, 101, 114
Bill of Sale, 114
check-in/out list, 179–180
for closing, 209
contracts, 179, 182–192
copies of, 228
Escrow Payoff, 114
Lead-Based Paint Disclosure, 102, 114, 180, 192
Letter for Due on Sale Clause, 114
Limited Power of Attorney, 114
memorandum of option, 100–101, 106–107
Notice to Insurance Company, 114
Notice to Mortgage Company, 114
Offer to Purchase/Purchase Agreement, 113
option agreement, 99, 108, 183–184
purchase agreement, 87, 100, 109, 126, 183, 191–193
rental agreement, 99–100, 108–109, 182–191, 201
revocation letter, 201–202
Seller’s Acknowledgment, 113, 117
Seller’s Disclosure, 101, 114, 180, 192
sources for documents, 228
subject-to deal, 113–114, 116
Warranty Deed, 24, 113, 116
Double-closing, 208
Down payment, 46, 51, 86
Driver’s license, as identification, 169, 178
Due on sale clause, 47–49, 56

Economic conditions, impact of, 81, 244
Employees, hiring process, 229–231
Employment status, importance of, 170, 178
Entry points, 188, 234
Equity Trust, 52
Escrow account, 71
Escrow Payoff, 114
Ethical guidelines, 50, 56
Ethics:
capital gains, 129–130
Realtors’, 148–149
Eviction, 182–185, 187, 201–202
Exercising the option, 194, 216
Exit strategy, 22–23, 70, 234
Extensions, request for, 131
Fair housing laws, 171–172
Federal regulation, 39, 168, 172
Fee(s):
attorney, 190
late, 203
pet, 193
transfer, 72, 126, 157
types of, overview of, 185–187
FHA financing, 58, 101, 157, 192
File system, 221–223, 228
Financially strong sellers, 53–55
Financing, sources of, 46
Fire, 190, 213
First deals, case illustrations, 18–20
First mortgage, 71, 73, 75
First-time buyers, 25
Fixtures, terms and conditions, 191
Flexibility, importance of, 26–27
Flyers, 34
Follow-up, importance of, 146–147, 237, 239–243
Foreclosure, 36, 48–49, 171, 185
Forfeiture, 185
For rent ads, 35
For Sale By Owner (FSBO), 37, 85, 90
Fraud, 49, 171
Future Financial Freedom (FX3) program:
action plan, 232–244
business organization, 221–232
Garnishment, 176, 204
Gifts, move-in, 193
Goal-setting, importance of, 238–242
Good buyers:
qualifications of, 168
who turn bad, 201–204
written standards for, 168–169
Good credit, 166–167
Good debt, 36, 45–46, 55–56
Government mortgage, 192
Grantor, land trust, 48
Growth rate, 244
Handyman specials, 214–215
High-end market, 127
INDEX

Holding over, 191
Home-based businesses, 190
Home construction, 46
Home equity, 54–55, 57–58
Home owners, types of:
  inherited, 55
  long-time, 55
  new home builders, 55–56
  newly married, 56
Home selection, 244
Honesty, importance of, 49, 148
Hot markets, 127
Illness, economic impact of, 45
Income check, 46, 52
Inherited property, 55
Inspection, 115, 188, 192
Insurance, generally:
  coverage, 40, 115, 190
  liability, 40, 103–104, 109
  owner’s proof of, 104
  policies, types of, 87
  policy payments, 48–49
  renter’s, 181, 190, 193
Integrity, importance of, 148
Interest rates, 47
Internal Revenue Service (IRS), 53, 129, 217. See also Taxation
IRA, 47, 52. See also Roth IRA
Job transfer, 46, 56
Joint and several liability, 188
Judgments, 171
Keys, possession of, 102, 115, 193
Kitchen maintenance, 200
Land contract, 165
Landlord(s):
  history, 169
  motivated, 38–40
  land trust, 47–48, 123–125
Late fees, 185–186, 203
Late payments, 203–204
Lead abatement, 102, 182
Lead-Based Paint Disclosure, 102, 114, 180, 192
Leads:
  for tenant-buyers, 162–163
  wholesale deals, 51
Lease option(s), generally:
  advanced selling strategies, 214–215
  advantages of, 5, 51–52
  case illustrations, 8–11, 59–60
  characteristics of, 3–4
  defined, 44
  matching motivated sellers with, 54–56
  negotiations, 82
  preparation for, see Preparation for lease option deal
  profitability of, 64–69
  pros and cons of, 56–58
  questions and objections, 85–88
  Realtor’s commission and, 151–153
  risks, 52–54
  standard deals, 6–8, 17
Lease Option Boot Camp, 20, 234
Lease purchase, sample proposal, 156–158
Letter for Due on Sale Clause, 114
Liability:
  insurance policies, 40, 103–104, 109
  protection, 188
  of tenant, 190
Limited liability company (LLC), establishment of, 236
Limited Power of Attorney, 114, 126–128
Listing agent, 137
Litigation, 180, 213–214, 223
Loan qualification, 46
Lockbox, 181, 193
Locks, changing, 200
Maintenance, see Property management; Repairs
  co-pays, 205
  responsibility for, 188–189
  types of, 200
  work list, 105–108, 116
Marital status, significance of, 46, 56
Marketing plan, 21
Market value, 81, 90. See also Comparables
Mediation, 182
Medicaid, 125
Medical problems, economic impact of, 167
Index

Memorandum of option:
- characteristics of, 53, 58, 100–101, 106–107, 121
- filing process, 184

Month-to-month rental agreement, 184, 186

Mortgage, generally:
- back payments, 70–71
- fraud, 47
- non-owner occupied, 52
- payments, 44, 86
- payoff, 210–211
- performance, 121–123
- rejection, 173
- second, 71, 73, 75, 92, 207–208
- sources of, 131
- statement, as information resource, 98–99, 113
- status, 113, 116
- underwriters, functions of, 101

Mortgage broker:
- code of conduct, 50, 56
- functions of, 168, 173, 184, 192, 238

Mortgage lender:
- functions of, 209
- payoff letter, 210–211

Motivated sellers:
- characteristics of, 31–32
- search techniques, 33–38, 41

Move-in costs, 186

Moving in/moving out, preparation for, 173, 193–194, 199–200, 205

Multiple Listing Service (MLS), 37, 64, 81, 135

Multiple offers, 33, 83

National Association of Realtors (NAR), 37

National Real Estate Investors Association, 39

Negligence, 190

Negotiations:
- economic conditions and, 81–82
- guidelines for, 63–64, 67, 75
- length of term, 93
- lock-in agreement, 93
- psychology of, 79
- with Realtor, 154

- seller paying you to take over payment, 93
- seller pays part of payment, 92–93

Networking, 138–139, 237

New home construction, 55–56

Newspaper ads, 34, 40–41

Non-owner occupied mortgage, 52

Not desperate/not distressed sellers, 32

Notices:
- characteristics of, 190–191
- Notice to Insurance Company, 114
- Notice to Mortgage Company, 114

Nursing homes, 125–126

Occupancy, 187–188

Offer, see Proposal/offer guidelines
- creation of, 62–63
- development of, 154–155

Offer to Purchase/Purchase Agreement, 113

Office manager, selection factors, 230–232

Office supplies, 235–236

Option agreement, components of, 99, 108, 183–184

Option fees, 15–16, 21, 173, 176, 192

Ordinances, 190

Out-of-pocket costs, 68–69

Out-of-state owners, 37

Owner folder, filing system, 97

Ownership, 44, 46, 53

Painting, 200

Partial payoff, 54

Partnership(s):
- accountability, 238, 240–243
- with seller, high-end/hot markets, 127, 132

Part-time employees, 230

Payment(s):
- history, 225
- late, 203–204
- ledger, 224–225
- setting up, 105, 107, 116

Payoff letter, 211

Performance mortgage, 121–123

Pet(s):
- deposit, 186
- fees, 193
- policies, 188, 192–193
INDEX

Photographs, for protection, 193
Pools, 184
Pre-Paid Legal attorneys, 182, 236
Preparation for lease option deal:
  advertising, 102
  checklist for, 96–97
  documentation, 99–100, 104–107
  keys, 102
  liability insurance, 103–104, 109
  liens, IRS/state tax, 98
  maintenance/work list, 105–108
  mortgage statement, 98–99
  owner folder, 97
  owner's proof of insurance, 104
  payments, setting up, 105, 107
  pretitle work, 97–98
  property taxes, 99
  title work, review of, 104
  utilities, 102–103
  water reading, 103
  water softener, 103
Preparation for subject-to deal:
  advertising, 115
  checklist, 111–112
  documentation, 113–114, 116
  inspection, 115
  insurance, 115
  key possession, 115
  maintenance/work list, 116
  mortgage status, 113, 116
  owner folder, 112
  payments, setting up, 116
  pretitle work, 112
  property taxes, 113
  "Summary of Our Deal," 117–118
  tax liens, IRS/state, 113
  title work review, 115
  utilities, 115
  water reading, 115–116
  water softener, 116
Presentations, preparation for; 144–145
Pretitle work, 97–98, 112
Price objections, 90–91
Principal, interest, taxes, and insurance (PITI), 52, 72
Privacy issues, 198
Profit(s):
  increase strategies, 204–205
  ranges, 17
  requirement, calculation of, 63–64
Profitability:
  for lease options, 64–69
  profit requirement, calculation of, 63–64
  "Stupidest Moves Award," 61–62
  for subject-to deals, 69–75
Property management:
  case illustration, 195–197
  maintenance, types of, 200
  moving in/moving out, 199–200
  privacy with tenant, 198
  repairs, responsibility for, 198–199
Property manager:
  functions of, 202–203
  selection factors, 230–232
Property taxes, 54, 99, 113
Proposal(s):
  creation of, 238, 240–244
  guidelines for, see Proposal/offer guidelines
  sample, 156–158
Proposal/offer guidelines:
  determination of, 82–83
  format, 79–82
  negotiations, 82–84
  rejection of, 84
  research, 81–82
  seller's objections, 84–92
Pro-seller forms, 176
Protection guidelines:
  for lease option, 120–123
  for subject-to deals, 123–125
Purchase agreement, components of, 87, 100, 109, 126, 183, 191–193
Purchase and sale agreement contract, 93
Quickbooks, 223
Rapport-building:
  importance of, 89
  techniques, 76–79
Real estate courses, listening to, 239–243
Real estate investor clubs, 38
Real Estate Investors Association (REIA), 236–237, 241–243
Real estate license, 238
Real estate sales, traditional, 136
Realtor(s):
  closing deals with, 150–158
  code of ethics, 56–57
Index

contact strategies, 140–141
deal structure and, 153–158
disclosure by, 192
educating, 142–145
ethics, 148–149
follow-up with, 146–147, 237, 239–243
letters to, 34
listing with, 88, 91
meeting with, 143–144
networking with, 138–139, 237
presentation for, 144–145
rapport with, 20–22, 52, 146–147, 152
referrals from, 165
selection factors, 137–138
targeting, guidelines for, 141–142
training for, 171
working with, 135–137
Recordkeeping system, 213, 223, 228–229
Red flags, 170, 191
References, checking, 169–170
Referrals:
   from Realtors, 165
   sources of, generally, 21
   from tenants, 166
Refinancing, 49, 56–57, 129, 131
Rehabilitation, 78
Reinvestment, 16–17
Rejection, handling strategies, 84–92, 172–173
Rejection letter, 178
Rent, 35, 40, 187
Rental agreement:
   month-to-month, 184, 186
   violation of, 201
Rental fees, 186
Rental payment, 51–52
Renter's insurance, 181, 190, 193
Repairs:
   cost of, 211, 213, 224
   responsibility for, 16–17, 183, 188–189, 192, 198–199
Repossessions, 171
Research, importance of, 81
Return on investment (ROI), 47, 52
Revocation letter, 201–202
Revoking options, 201
Risk, 51
Roth IRA, 47, 243
Seasoning of title, 56, 58, 101, 209
Second mortgage, 71, 73, 75, 92, 207–208
Section 8 Housing, 215
Security deposit, 93, 174, 186, 205
Security Deposit Act, 190
Seller(s), generally:
   closing with, 210
   financing, 165
   first contact with, 41–43
   folder, 222
   motivated, see Motivated sellers
   rapport with, 52
   situation, 45–46
   Seller's Acknowledgment, 113, 117
   Seller's Disclosure, 101, 114, 180, 192
   Seller's Information Manual, 91
   Seller's market:
      characteristics of, 28, 32–33, 81
      deal structure, 153–154
      lease options, 152–153
   Selling options checklist, 177–181
   Septic systems, 184
   Showings, 40
   Signs/signage:
      attracting tenant-buyers, 166
      removal of, 181, 193
   Skip-trace services, 37–38
   Slide presentations, 144
   Sob stories, dealing with, 202–204
   Social Security number, as identification, 178, 193
   Soft rental markets, 215
   Software, selection factors, 223–224
   Spreadsheets, 70
   State regulation, 39, 56, 172, 182
   Statutes, 190
   Subject-to deals:
      advantages of, 46–47
      case illustrations, 12–15, 24–28, 59–60
      characteristics of, 4
      defined, 44
      ethical guidelines, 50
      first deals, 25–26
      first-time buyer, 25
      negotiations, 82
Subject-to deals (Continued)
profitability, 69–75
pros and cons of, 56–58
questions and objections, 88–92
risks, 47–51
standard deals, 8
Subletting, 188
Success story, sample, 205–206
Sweat equity, 214

Taxation:
back taxes, 72
impact of, 53
liens, 98, 113, 170
property taxes, 54, 99, 113
proration, 192
reduction strategies, 216–217
Tax-deferred exchange, see 1031 exchange
Tax liens:
implications of, 170
IRS/state, 98, 113
Team-building guidelines, 238–239
Telephone service, 193
Tenant(s), see Tenant-buyer
folder, contents of, 178–179
liability, 190
list, 225–228
referrals from, 166
Tenant-buyer:
closing, 210
contract signing, 212
defined, 19
folder, in filing system, 178–179,
222–223
lease option risks, 53
paperwork, see Tenant-buyer paperwork
relationship with, 203
screening process, 169–173
selection factors, 155, 161–166
Tenant-buyer paperwork:
contracts, types of, 182–192
preparation of, 175–181
review of, 181–182

1031 exchange, 39, 216–217
Term, length of, 93. See also Extensions
Testimonials, 89
Time line, for action plan:
initial 12 weeks, 235–241
months 4 through 12, 241–244
Title, generally:
characteristics of, 56–57
transfer, 47, 184, 192, 200
work review, 115
Title companies, functions of, 209, 239
Title insurance, 72, 157
Transfer fees, 72, 126, 157
Trustee, land trust, 48, 124
Underwriters, functions of, 101
Unemployment, economic impact of, 45, 167
Unknown credit, 166, 168
Up-front funds, 72
Utilities, 180, 193. See also Water
Vacancies, 40
Vacant homes, implications of, 37, 59–60
VA financing, 157
Valuation, see Comparables; Market value
Vehicles, terms and conditions, 191
Videotape of property/premises, 179, 199–200
Waiver, 191
Walk-through, 179, 193, 199–200
Warranty Deed, 24, 113, 116
Water, generally:
bills, 204
reading, 115–116
softener, 116
Weak market, 33
Web sites, advertising on, 164, 166
"We want it now" mentality, 167
Wholesale deals, 51, 63, 132
Work orders, 224
Written standards, 168–169
Zoning laws, 190