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# Rent-To-Own Homes: How The Process Works

In a typical home purchase, the sale takes place shortly after the offer has been accepted, and the transaction is completed at closing. Since most buyers don't have the money to pay cash, a mortgage is usually used to finance the purchase: The buyer puts down a certain percentage of the purchase price (the down payment), then pays the lender in regular installments over a period until the balance is paid off in full.

To qualify for a mortgage; however, potential buyers need to have a good credit score and cash for a down payment. Without these, purchasing a home in the traditional way may not be an option. There is an alternative: a rent-to-own agreement. When buyers sign this kind of contract, they agree to rent the home for a set amount of time before exercising an option to purchase the property when or before the lease expires.

Here's how rent to own works, and when it may be a good choice for someone looking to buy a home.

## Elements of a Rent-to-Own Contract

In a rent-to-own agreement, potential buyers get to move into a house right away, with several years to work on improving their credit score and/or saving for a down payment. A rent-to-own agreement typically rents the property for a set amount of time (usually one to five years), after which he or she can purchase the house from the seller. It's not as simple as paying rent for five years and then buying the house: Certain terms and conditions must be met, in accordance with the contract.

**Option Money:** In a rent-to-own agreement, the potential buyer pays the seller a one-time, usually non-refundable fee called option money, or option consideration. This gives him or her the option to purchase the house in the future. It is important to note that some contracts (lease-option contracts) give the potential buyer the *right* but not the *obligation* to purchase when the lease expires. If he or she decides not to purchase the property at the end of the lease, the option simply expires. If the wording is "lease purchase," without the word option, the buyer could be legally obligated to purchase the property at the end of the lease.

The size of the option is negotiable. There's no standard rate. It typically ranges between 2.5% and 7% of the purchase price.

**Purchase price:** The contract will specify when and how the purchase price of the home will be determined.

**Rent:** During the term of the lease, the potential buyer pays the seller a specified amount of rent, usually each month. The lease term is negotiable but frequently ranges between one and five years. In many contracts, a percentage of each monthly rent payment is applied to the purchase price. For example, assume the contract states that the buyer will pay $1,200 each month for rent and that 25% of that will be credited to the purchase. If the lease term is three years, the buyer will earn a $10,800 rent credit to apply toward the purchase ($1,200 x 0.25 = $300; $300 x 36 months = $10,800). Often, the rent charged by the seller will be slightly higher than the "going rate" for the area to accommodate the rent credit the buyer receives.

**Purchasing the property:** If the potential buyer decides not to purchase the property (or is unable to secure financing) at the end of the lease term, the option expires. The buyer forfeits any money paid until that point, including the option money and any rent credit earned. If the buyer cannot purchase the property but has a legal obligation to (as stated in the contract), legal proceedings may be initiated.

If the buyer wants to purchase the property, he or she typically applies for financing (i.e., a mortgage) and pays the seller in full. According to the terms of the contract, a certain percentage of the option money and rent paid may be deducted from the purchase price. The transaction is completed at the closing, and the buyer becomes a homeowner.