LEASE-PURCHASE WHITE PAPER

The situation:

Neighborhood Stabilization Program funds are now available to redevelop foreclosed and abandoned properties. The funding comes at a time when many nonprofit developers are holding an unsold inventory of homes they have developed. Buyers are skittish about buying while prices are still declining and the economy is slowing, and some buyers are not ready to invest in certain neighborhoods. Mortgages are also more difficult to obtain. In such a down real estate market, many nonprofits believe that continuing to develop more for-sale homes may not be the best option.

However, this economic situation also provides nonprofit developers new opportunities to obtain foreclosed or troubled properties available at reduced prices.

Lease-purchase offers a unique solution that nonprofit developers can use to take advantage of the bargain acquisition opportunities and soon-to-be-available capital opportunities, without increasing an inventory of unsold properties.

Opportunities for action:

- For nonprofit developers with completed and unsold single-family housing, a lease-purchase program can attract lessees who will eventually purchase and become homeowners. In many communities, there are likely more potential clients who may currently be ineligible for a mortgage but have future potential than there are mortgage ready buyers.

- For nonprofit developers holding back on production because of fear of houses not selling, a lease-purchase program provides a higher probability that there will be "purchasers."

- In some communities, houses can be purchased at bargain prices as part of a neighborhood revitalization strategy, yet there is reluctance to move forward without a market to sell these homes. A lease-purchase program

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will both provide occupants for the renovated units and stabilize prices through a fixed price created at the beginning of the lease period.

- Because of tightened requirements, many potential buyers with credit flaws cannot currently secure mortgages. Lease-purchase allows potential buyers to repair or improve their credit while occupying the house they will eventually buy.

- Recently passed federal legislation includes nearly four billion dollars in special Community Development Block Grant (CDBG) funding to support state and local efforts to stabilize neighborhoods with high numbers of vacant and foreclosed-upon homes. H.R. 3221 requires states and local governments receiving neighborhood stabilization funding to use these funds within 18 months of receipt, and grantees are not required to provide a match for these special CDBG funds. Lease-purchase can be used as a mechanism to immediately purchase and redevelop foreclosed and abandoned properties and have an occupant who can eventually purchase.

- While allowing for incomes of up to 120% of median, the emergency CDBG funds also requires 25% of the funds to go to households with incomes of less than 50% of median. A lease-purchase program can be structured to be affordable for lower income families who can use the leasing period to prepare and qualify for homeownership.

Making a lease-purchase program successful

Lease-purchase is a mechanism to hold and occupy properties on a temporary basis and sell when the buyer is ready and the market improves. Lease-purchase is a useful tool to “prime the pump” in a campaign to market a community. However, it is crucial that nonprofit developers contemplating a lease-purchase program carefully plan and proactively think about options and consequences of this program model. Indeed, many communities have had problems with unscrupulous investors using a variation of a lease-purchase program that ultimately hurt the buyers and their neighborhoods much like sub-prime loans. Yet there are many examples of successful lease-purchase programs managed by nonprofit housing developers. Lessons have been learned from both successful and failed programs.

Most nonprofits that have had bad experiences with lease-purchase backed into lease-purchase out of desperation or entered into it without a deliberate, well-planned program. The guidance of an experienced lease-purchase professional can prove helpful in creating a sound plan. Elements of successful lease-purchase programs include:

- Pre-determining the level of risk the sponsoring organization is willing to take in underwriting potential lease-purchasers. Determine the acceptable range of credit flaws beforehand. Lease-purchasers are not just everyone who does not qualify for a standard mortgage.
- Tailoring the time period of the leasing phase to correspond to the level of risk.
- Having an exit strategy for when the lessee does not perform.
- Developing a well structured lease-to-own contract agreement.
- Providing a specialized pre-purchase counseling program tailored to a lease-purchaser.
- Having a clear understanding of the role of property management including eviction. During the leasing period the nonprofit sponsor is a landlord and needs to be prepared to evict if the lease-purchaser does not work out as a tenant.
- Structuring the financing and final sale price as part of the normal development process in the feasibility stage.
- Securing the special kind of financing needed for lease-purchase.
- Determining the monthly lease payment according to the ultimate sale price and operating costs.
- Consulting with a real estate attorney who is familiar with local tenant-landlord laws to review the lease-purchase contract.

A professional training course in lease-purchase would also be helpful. NeighborWorks®America offers such a course at their training institutes.

Lease-Purchase is an important tool for affordable housing developers and neighborhood revitalizers. It is a particularly helpful tool in this period of housing market uncertainty. The confluence of nonprofit housing developers needing to continue production, foreclosed properties threatening viable neighborhoods, and new federal capital sources available for addressing these issues, requires a model like lease-purchase. With expert advice and training, successful lease-purchase programs are possible.