

Closing Issues on Lease Purchases

The 4th article in a series by Robert M. Locke

When I started doing Lease Purchases in 1988, I had the same pie-in-the-sky expectations that most investors have concerning LP. I assumed the tenant would take great care of the property, handle all the maintenance, pay rent on time, never bounce a check and close as agreed. These and other naive expectations got me in real trouble in the first five years of my LP business. Little did I know that my model (the way we “think” things are suppose to go) did not consider the “human factor” (the way things “really are”). As it relates to “closing issues” there two primary issues (there are many others) that we are focusing on in this article.

The first is that “the mortgage world is a moving target.” We as investors forget that things in the mortgage business don’t always remain constant, and our tenant may not be able to get a loan when they need one. We often base our expectations on *what is happening today, not what might happen tomorrow*. With things heating up in the middle-east, gas prices rising daily, Iran developing WMD and North Korea testing missiles, there is little certainty of what interest rates are going to be in the future. My first year in Atlanta real estate was 1980 and I saw mortgage rates increase from 9% to 18% in nine months. Us old guys are around to remind the rest of you that two years from now might look very different than it does today. Don’t bet too much on your LP’s closing the way you expect.

Second is the ever-changing formulas the mortgage industry uses to qualify our tenant-buyers for their loan. We have seen lenders’ magnifying glasses get much bigger in the last five years as to what they require to get a LP closed. Here are some suggestions.

1. Be ready to prove the existence of the earnest money check.

Loan fraud being what it is, lenders are more suspicious than ever regarding the “non-refundable earnest money check the tenant gave you on the front end of the deal. I am a licensed broker with escrow accounts to account for all the money I receive from others, (just like closing attorney’s) and the lenders are not convinced by my escrow report as to the receipt of earnest money. They do not think broker escrow accounts are reliable. They have learned from experience that brokers can manipulate reports and *they do not trust us for this information and they will trust you*. We have learned to make copies of the earnest money check from the tenant and keep it in our file. We also encourage the tenant to keep their canceled check for the lender to see.

2. Be ready to modify the Rent Credit strategy before closing.

Lenders do not like rent credit. They think it is just funny money and for good reason. I have seen LP’s with rent of \$1,000 and rent credit of \$300. Who’s kidding whom? Is the fair market rent really \$700 or is this smoke and mirrors? I have seen motivated builders offer 50% rent credit to lease purchase their slow inventory. Lenders don’t want to see rent credit on the HUD so be ready to modify your agreement with the tenant at the last minute and call it something the lender understands (like closing costs). *Tenants love rent credit.... Lenders don’t.*

3. Closing attorney's miss-handling the earnest money.

Most closing attorneys (and lenders) use standard software that treats the earnest money as being held by a broker and available at closing for some of the closing expenses. The “default handling of earnest money” puts it on the buyer’s side of the HUD only. This is a mistake, of course, as it has already been paid to the seller. *The earnest money must be shown on both sides of the HUD.* A credit to the buyer and a debit to the seller. You will need to discuss this with the pre-closer in advance as it is “out of the norm” and they get it wrong most of the time.

4. Lenders asking you to “re-do” the purchase and sale agreement.

A creative loan originator will often ask an unsuspecting seller (or broker) to “rewrite the purchase agreement to fit their lending formula and backdate it to the original move-in date”. This is a common request but it is clearly loan fraud. **You may go to jail for this act but the loan officer won't.** *Never redo a purchase agreement and backdate it.* Modify the purchase contract with a standard addendum, date it today, and make the lender change their formulas and close or kill the deal. This works most of the time and will keep you out of jail.

5. When late rent is not really late.

Lenders will ask the landlord if the tenant has incurred any late fees during the rental period. My rents are due on the first and late on the second. If I report late fees to the lender it will kill the deal. What the lender is really asking is, “Has the tenant paid rent after the 15th (or the 30th)?” We do not send the lender a copy of the tenant payment ledger as it may show some late fees when it was not “late” according to the lenders definition. Ask the lender for a VOR (verification of rents) and fill it out carefully, noting only “late rent” as they define it.

Closing Lease Purchases can be tricky, especially if you are in your learning curve. Take a good course from someone who has already paid for their learning curves. It can save you a lot of time and money. There is a good one at www.CrownInvestorInstitute.com.

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