

The simpler, the better

After just a year and a half, Mike Holmes has nine properties under his belt for a total of \$20,491 in monthly rental income, and 30 per cent of that is positive cash flow. Find out how lease options worked for him.

Mike Holmes of Thornhill, Ont., firmly believes there are only three ways to make real money in life – the lottery, stocks or real estate. He chose the latter, feeling it would

allow him to control his financial future while providing maximum returns. Investing in real estate was always something Holmes had been interested in, and it fit perfectly with his day-to-day life where he holds a full-time job in management.

In March 2007, Holmes attended a real estate seminar with guest speakers including Donald Trump, Tony Robbins and Richard Branson. From there, he continued to educate himself on the subject by attending several courses, all the while building a network.

It was a chance meeting with a representative from a lease-to-own company where Holmes felt he'd finally discovered an area he was comfortable investing within.

"Lease-to-own properties are more hands-off and less maintenance than most other real estate strategies and since I work over 50 hours a week at my full-time career, this option was

the best for me," says Holmes.

However, while Holmes was interested in investing and had enough equity built up in his own home to do so, he felt he didn't have the time to make educated decisions on his own. He decided to enlist the help of a lease-to-own company, which would do most of the research for him, and partner him with suitable tenants.

"It was a perfect match," he says.

Lease options

The first step when investing in a lease option is to find a tenant, commonly referred to as an occupant, who wants to purchase a home and has a good income, but may not be able to obtain financing. Often, this is due to a weak credit score. Occupants can be found through word-of-mouth, lease-option companies or by establishing a strong relationship with a broker.

Next, perform a background check (credit score and income) on the potential occupant and advise him or her of what property price and mortgage amount he or she could comfortably



Brampton property

Gross monthly rental
income: \$1,955



afford. The occupant then scours the market for a home of his or her choice. After picking the property, the investor performs his or her due diligence.

“I look for cities that are growing, have good core businesses, are places where people want to live and have a municipal government that is doing things to attract growth for businesses and people,” says Holmes.

If all criteria are met, the investor should draft a contract with the help of a lawyer for a two- or three-year term. The contract should include the agreed monthly rental amount, property appreciation rate (typically five per cent annually) and a clause that the occupant has the option to purchase the home at the end of term.

“I felt it was important to get to know the occupant since we would be partners in this transaction for two years”

“Both the occupant and the investor are aware of this,” he says. “This provides a guaranteed return for the investor, plus cash flow each month.”

Upon signage, the investor puts an offer on the home, negotiates the price and purchases it.

While it may sound simple, there is one consideration for investors – the occupant may decide against purchasing the home at the end of the lease. However, Holmes says, this rarely occurs since the occupant risks losing his or her

initial deposit (usually between \$5,000 and \$10,000), as well as the equity that has been built in the home.

With his own investments, Holmes typically puts aside about \$300 of monthly rental income per property towards equity for the occupant. So, after a two-year term the occupant would have about \$7,200 built up in equity, along with his or her initial deposit, to put towards a down payment on the home.

Holmes purchased his first investment

Gross monthly rental
income: \$2,250

property - a single-family home for \$220,000 in Barrie, Ont., in January 2008. He recalls meeting the occupant and touring through the home together.

"I felt it was important to get to know the occupant since we would be partners in this transaction for two years," he says.

This experience taught him that insurance companies can be relatively strict when it comes to older homes. Holmes had to assure the oil tank would be replaced within six months, or the company refused to insure the home.

"I spent more time with the insurance company on the first lease option home than with the lawyer, accountant and banker all put together," he says. "I certainly learned patience from that experience. I also kept detailed notes of all the steps necessary when doing a lease option transaction, which certainly helped me on my future deals."

Benefits

Lease options have two great draws, according to Holmes.

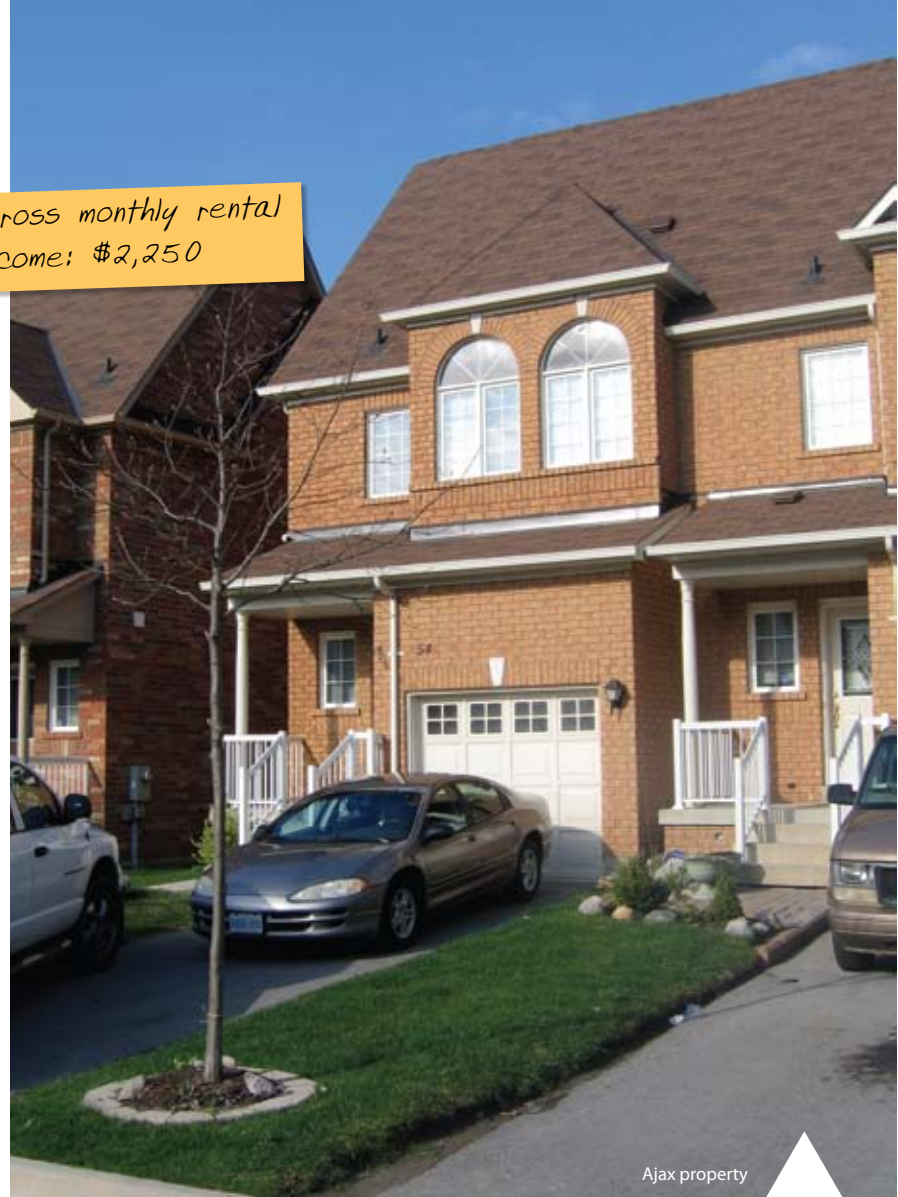
The first is that the occupant maintains the home because in two or three years they will own it, thus they take pride in the property and in many cases improve and renovate it. This contrasts vastly from typical renters, he says.

"The second benefit is that I'm helping people who have had financial setbacks in their lives and are looking for a second chance and want to own a home."

When speaking on today's economy, and whether lease options still make sense, Holmes is adamant in stating that 'yes, they do.'

"At this point, where property prices have dipped and the initial agreed upon appreciation rate might not make sense, the occupant has the option to walk away," he says. "However, they'll lose the equity and the deposit, but that's up to them to decide.

"Also, you've got to keep in mind that the price of houses or real estate is like the stock market, which fluctuates. In a down economy, the house may have dipped in price, but the following



Simple guide to lease options

1. Find a tenant with a good income who wants to own a home, but a less-than-perfect credit score may be holding them back. Your mortgage broker or a lease option company can help here.
2. Perform a background check on the potential tenant. Ask for proof of income, credit and references.
3. Advise the tenant of how much he or she can afford in mortgage payments and total property price. Let him or her pick a home.
4. Do your due diligence. Check the fundamentals of the city and the property itself. Assure the numbers make sense.
5. If all criteria are met, draft a contract with the help of a lawyer. Include details such as the agreed monthly payment amount and price appreciation.
6. Put an offer on the home and purchase it.
7. After the two- or three-year term is up, the tenant then has the option to purchase.

year it could go up in the double digits. Even if you're left with an occupant who chooses not to purchase the home, you've still built equity in the property and have various options (such as renting or holding) until the market picks up and you can sell."

Next up

Holmes' most recent deal, a single-family home in Winnipeg for \$240,000 with a monthly rental income of \$2,050, follows the same tried-and-true method that he is accustomed to.

His network of contacts includes a



Property portfolio – single-family homes

Location	Purchase date	Purchase price	Current value	Gross monthly rental income
Barrie, Ont.	January 2008	\$220,000	\$240,000	\$1,870
Barrie, Ont.	May 2008	\$300,000	\$330,000	\$2,540
Timmins, Ont.	August 2008	\$133,000	\$140,000	\$1,126
Brampton, Ont.	August 2008	\$230,000	\$235,000	\$1,955
Fort McMurray, Alta.	August 2008	\$575,000	\$605,000	\$4,900
Ajax, Ont.	November 2008	\$263,000	\$270,000	\$2,250
Niagara Falls, Ont.	November 2008	\$236,000	\$242,000	\$2,000
Fenelon Falls, Ont.	February 2009	\$209,000	\$212,000	\$1,800
Winnipeg, Man.	May 2009	\$240,000	\$240,000	\$2,050
TOTAL		\$2,406,000	\$2,514,000	\$20,491

mortgage broker in Winnipeg, who got in touch with him about potential clients that had a good income and wanted to purchase a home that was at a good price.

“I checked to make sure the property was in a decent neighbourhood, had a home inspection done and had it

appraised,” he says. “It seemed to be a profitable deal and I had them sign the lease option.”

Overall, Holmes finds lease options aren’t as complicated as other real estate investments.

“Remember, you have a motivated occupant who wants to own the

property at the end of the time frame, and a property that they have chosen,” he says. “I ensure that the basic fundamentals are done whenever I buy any property and the real key is the occupant. The occupant is your partner in the transaction - they are the real investment.” 🏠



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Investor profile Report card

Real estate professor **Paul Sloggett** reviewed the investment strategy of Mike Holmes and provided this feedback



Research

Grade: **B+**

Comments: Mike Holmes gained his initial interest and some education at a real estate seminar and continued his research into lease-to-own options, which help protect both parties.

Mike was able to realize his job in management consumes most of his time and as a result sought out the expertise of a lease-to-own company.

Further, Mike has also surrounded himself with the needed expertise of lawyers, accountants, brokers and bankers, which will also relieve him of unnecessary worry.

Location

Grade: **B**

Comments: Mike indicates that he looks for investments located in growing cities, with good core businesses and a municipal government that will attract future growth.

A major concern to Mike will be the cost to manage the properties, to oversee the lessees, to measure the quality of the lessee and to monitor the economic indicators that fuel the real estate market. These costs in a declining market will make lease-to-own potentially less viable.

Timing

Grade: **B**

Comments: In hindsight, Mike has purchased the majority of his real estate property during the peak of the economic cycle and both Ontario and Alberta are experiencing economic downturns not only in the real estate market but in many of the economic indicators. Job losses are increasing and the "fear factor" has taken hold such that many of the lessees may wish to break the lease-to-own contract and walk away from their investment leaving Mike with vacancies and possibly lower than expected rents.

On the upside Mike will have the extra monies charged above the monthly rents to address the lower rents and possibly weather the economic downturn.

Financing

Grade: **B**

Comments: As Mike indicated, he has collected an extra \$300 per month of rental income that is to go towards equity for the lessee and is good protection against default by the lessee. Mike made a good observation - "that someone who is participating in a lease-to-own is more apt to take care of the premises, and possibly make renovations etc." but again the question is how this is being monitored and what is the cost to monitor it as all of Mike's real estate investment properties are far from where he currently resides.

Plans for improvement

Grade: **B**

Comments: In order for this type of real estate transaction to occur without problems both sides may want to consider a "three-strike clause" that would permit up to three late payments by the lessee before the homeowner/investor can repossess the home and keep the investment, as one party's goal is to become the owner while the other party hopefully wants the sale to actually occur.

In addition to the "three-strike clause," Mike may also wish to insert a clause referring to Assignable vs. Non-Assignable where an assignable lease-to-own means that the lessee can give another person the opportunity to buy the property at the set purchase price.

Mike would be wise to put in a "Non-Assignable" paragraph to make sure that he is protected in the instance that the market takes off and the lessee is not in a position to buy the house. In that case, Mike can sell it at market value to another party and not risk that the lessee is striking a deal with another investor.

General comments

Trust is also an important element of the lease-to-own. As a seller, you must have confidence in the buyer to follow through, and a buyer must have faith that the seller will not try to find a way to get out of the deal with the extra monies built up in the rent payments towards the equity.

If the lessee is interested in the lease-to-own agreement, Mike, the investor, is wise to ensure that the lessee's credit, savings and employment status will qualify him or her for a loan to purchase when the time comes. Having a lease-to-own will not itself secure the lessee's ability to obtain a loan for the property - the lessee will still need a lender to qualify him or her. Mike will still demand a mortgage commitment. Mike is wise to obtain authorization for a credit check on the lessee's net worth statement so a mortgage professional can determine whether the lessee qualifies for a mortgage.

