Lease-to-Own Agreements: Flexibility for Landlords, Tenants, and Commercial Real Estate Professionals

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In today's environment of high interest rates and severe restrictions on traditional loans, it is often difficult for buyers to obtain commercial loans to purchase real property. Moreover, the requirements of traditional lending options for purchasing real property can be cumbersome and not every small business is eligible for such loans. Moreover, Landlords may wish to lock in tenants for a longer lease term or at a higher monthly rent amount in exchange for providing tenants the ability to purchase the leased property at a later date. As such, lease-to-own agreements can be an effective and beneficial arrangement for both landlords and tenants.

Lease-to-own agreements involve a lease with specific provisions that allow the tenant to purchase the leased property within a certain period of time, on specified terms. Such agreements can be structured in multiple ways, to either preserve flexibility or to lock in certainty. Some examples of lease-to-own provisions include the following:

Purchase Agreement Terms. The lease includes a fully executed purchase agreement attached as an exhibit (to be effective at the time the tenant exercises its purchase option), which locks in the purchase price and terms when the lease is executed. This provides certainty at the time of entering into the lease, by locking in the purchase price and terms at the beginning of the landlord-tenant relationship, and is especially useful in volatile markets.

Appraisal for FMV. The lease requires the parties to obtain an appraisal to determine the fair market value ("FMV") of the leased property at the time the tenant exercises its purchase option, and which FMV becomes the purchase price of the property. This

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can provide a fair solution if the parties cannot agree on a purchase price.

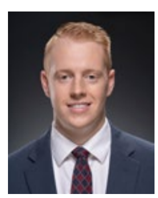
Consider Rent Credit. The agreement requires the landlord to credit the monthly rent payments towards the purchase price, once the tenant exercises its option. This option can allow the landlord to charge a higher than market rent up front in exchange for the tenant ensuring that all payments will eventually go towards purchasing the property. However, in the event of default, eviction may be difficult with the tenant arguing partial ownership.

Financing by Landlord. The lease requires the landlord (i.e., seller) to provide financing, which benefits the landlord by receiving additional interest payments and which benefits a tenant who cannot secure a traditional loan. The parties should be aware that the IRS sets minimum interest rates (called the applicable federal rate) for private loans between parties. Seller-back financing options often include a promissory note, deed of trust, and personal guaranty to be signed by the tenant.

Right of First Refusal. The lease contains a right of first refusal, which allows the landlord to market the property to third-party sellers, but allows the tenant to match such offers within a certain period of time after the landlord receives a third-party offer. This allows for greater flexibility for both landlord and tenant, but relies on third-party buyers to determine the timing and amount of the purchase option.

As the above examples show, lease-to-own agreements can be structured in numerous ways and create the ultimate flexibility for both landlords and tenants. Lease-to-own agreements can also benefit brokers working in commercial real estate. Whether an agent represents a landlord or tenant, the agents can negotiate additional consideration to be paid at the time the purchase option is exercised, as the agents will certainly be involved in assisting their respective clients through the purchase transaction. Thus, agents can increase a relatively small commission based solely on the value of a commercial lease to a much larger commission for a purchase transaction. As such, listing agreements and tenant/buyer brokerage agreements will need to be modified to account for the respective commissions to be earned at the time that the purchase option is exercised.

In summary, lease-to-own agreements provide the flexibility needed for landlords and tenants to navigate an ever-changing commercial property landscape.



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