

# Lease Purchase Profits: Setting the Price

*The first article in a series by Robert Locke*

I didn't hear much from the real estate industry about Lease Purchases until three years ago. There have always been seminars on Lease Option, but no one seemed to think Lease Purchase was a good tool for the real estate investor until recently.

We started doing Lease Purchases in the late 80's when the FHA investor loan programs dried up. We did them badly for the first five years as there were few places to go for training and our model, although perfect in our mind, had flaws in it. We used the standard brokerage forms because I am a broker, and they were the only Lease Purchase forms we could find at the time. As we made our mistakes and got through our learning curves, we found Lease Purchase to be a powerful tool and they make our investors a lot of money.

This series detail some of the learning curves we went through and is an attempt to pass on some of the experience we've gained regarding the Lease Purchase model.

**Let's talk first about setting the price.**

**Here's "what not to do":**

**Don't base the purchase price on an appraisal of the property in the future.**

The best way to get into a fight with your buyer/tenant is when they are getting ready to close and discover that the price is not what they expected. It maybe less ... then the tenants are mad, maybe more ... you are mad. Don't let the price float or be determined by another person some day in the future. We all know you can send three appraisers to the same house the same day and get three different values. They are likely to be thousands of dollars apart in their assessment. The appraiser could be your friend ... or worse ... their friend, and the fight is on. It's just not the way to have a happy ending.

Another reason this is a bad strategy is that the tenant never gets ahead. Buyers/Tenants need to feel like a Lease Purchase is a good deal for them too, and they need to feel that their work and efforts on the house will benefit them in the end. Under this appraisal method, every month that goes by they end up paying more for the house. If they are handling the maintenance and doing improvements (which you should encourage), they are driving up the price they are going to pay someday. This can become very discouraging for a buyer. If your strategy is to discourage them from closing, then you shouldn't care, but if you really intend to sell them the property, this strategy is counter productive.

I have also seen trainers suggest a "monthly escalation" of the price. I think the same argument applies as listed above. The buyer is going to get really discouraged watching the price move "a half of a percent a month" for instance. Each time they pay rent they say to themselves, "Today I am paying \$800 more for this house than I would have yesterday." Some will argue that this regular incremental price increase should motivate the buyer to close, but I doubt that's the driving force behind their decision. Most will close as soon as they can qualify, and regular price increases only aggravates them.

**Fix the price in advance.**

There might be a downside to this strategy if your property is located on the southern coast of California, certain parts of Florida, or some other part of the country where prices can escalate rapidly. If you fix the price, you need to be ready to close at that price. If the property value escalates dramatically during the term of the agreement, you might be unhappy with fixing the price. Since I have been doing this in Atlanta for the last 20 years I have not seen radical price movements in the market. Since Atlanta has no natural boundaries we will probably never see big swings in real estate values - either up or down. If builders want to find cheap land to build starter homes they just go a little further out and they find it. Twenty and 30% appreciation is unlikely in this town so I am comfortable predicting values a year or two out.

**Fixing the price in advance is my preferred strategy.** I didn't say "fixing it low." Fix it so you will be happy at the end of the term when it closes.

Real estate is an imperfect market. That means different people pay different prices for the same house; or, it means it is not easy to figure out what a house is really worth. You can go to most communities and find sales of the same house varying in price from \$10,000 to \$20,000. You ought to be able to make a good argument that your house is at the high end of that community. Set the price at the high end of today's range for the neighborhood and you will probably be happy when it closes.

One modification of this "fix it up front" strategy is to "fix it for the first year" and have a dollar adjustment for the next year. Buyer/Tenants don't seem to mind that so much because it is a year away and they will acknowledge that values do go up.

Occasionally we have buyers that cannot close at the end of the agreed term and still want to buy the property. We try hard to encourage them to stay. Not at the same purchase price of course, but keeping them is very important to our clients. Not closing as agreed is an appropriate time to increase the buying price and the Buyer/Tenant expects it. Don't disappoint them.

Watch for next month's article about maintenance issues on a lease purchase.

*Robert Locke is owner and Broker of Crown Realty & Management Corporation; "The Real Estate Investor's Choice" ®. Crown helps investors locate, buy, finance, rent, lease purchase, sell and exchange investment houses in the North Atlanta suburbs. Crown has guided investors in the acquisition of over 1,000 houses and 400 lease purchases. See more at [www.CrownGeorgia.com](http://www.CrownGeorgia.com)*