Lease-To-Own

There are many available choices for lease agreements. The lease-to-own model is an attractive option, but there are multiple things to keep in mind when choosing this type of agreement:

What to consider:

- Does the cost of land justify purchase over lease? Would it be better in the long run to continue leasing indefinitely (rather than working toward a purchase)?
- Does having a mortgage mean you're entering "death debt?" In other words, is it a realistic option for years to come?
- Are there any possibilities to place conservation easements on the property? Sometimes purchases become more feasible when they are in place.
- If you plan to buy right away will you have to spend all your start-up capital on the purchase?
- If you opt for a lease-to-own option will you be prepared to make the down payment for the property when necessary? This will depend on which of the below options you choose but is a critical question to consider.

Lease-to-Own Options:

1) Right of First Refusal:

- Guarantees that the owner will notify the tenant of their intent to sell the property.
- Owner can only sell to a third-party (not the tenant) after the tenant has had the chance to "refuse" or match the third-party offer and make the purchase first.

Advantages:

- Gives the tenant some security, knowing that the owner will not sell the property without their knowledge.
- Tenant has no obligation to purchase the property.

Disadvantages:

- Tenant must be prepared to purchase the property when the owner is ready to sell (including having financing lined up or being able to access financing quickly).
- Tenant might not have any room to negotiate the price because the landlord may have another buyer who is willing to pay what he/ she is asking.

2) Option to Purchase:

- Owner and tenant pre-determine the purchase price and time-frame for execution of purchase.
- Tenant may pay for option up front or percentage of rent money can count toward down payment.
- Tenant has exclusive right to purchase during the lease period. If the tenant chooses not to exercise their option to purchase, the owner can choose to convert to a traditional lease agreement or to find other tenants or buyers (depending on how the agreement is written).
- May be a stronger clause for a farmer, since there are fewer unknown variables from the outset.

Advantages:

- Helps ensure that owner does not sell the land "out from under" the tenant.
- When rent payment goes towards eventual purchase, tenant can build equity toward ownership.

Disadvantages:

- If the tenant is not financially ready or decides not to exercise the option, the option consideration is lost.
- If tenant and landowner decide to include an option consideration, there is great risk to losing the equity and investment in the property should tenant not move forward with the purchase.
- Fairly complex form of transaction to negotiate that requires time and expertise to arrive at equitable terms.

3) Installment Sale:

- An Installment Sale is a transaction with the down payment paid at close of escrow and the balance of the purchase price payable by a note and secured by a deed of trust which can be carried by the Seller.
- The purchase price is payable in monthly or annual payments. When the entire purchase price is paid off, the note is canceled and the deed of trust is reconveyed.
- Title transfers on close of escrow, typically within 60 days of contract of sale, securing the buyers control of property from onset. Also allows purchasing of title insurance which guarantees the seller's rights as first lien holder and buyer's legitimate ownership of property.

Advantages:

- Simpler and more secure format for both buyer and seller than other owner financed options.
- Buyer is able to slowly ramp up to ownership while also working the land and developing that asset (building soil fertility, planning out infrastructure, etc.).
- Buyers who aren't able to secure a traditional mortgage can still purchase a farm.

- A less risky option for both buyer and seller because note and deed of trust are established legal tools with inherent protections.
- When financed by the seller, the buyer can purchase without qualifying for traditional loan and the seller has both security and maintains foreclosure rights.
- Does not require going to court to reacquire title in the event of a default.

Disadvantages:
- Seller remains vulnerable until the entire purchase price is paid in full.
- If buyer must stop making payments, seller can foreclose on the property and reacquire title.

4) Land Contract Sale:
- A Land Contract is an installment contract between a buyer and a seller for the sale of the property – complete ownership is not transferred until all payments under the contract have been made. Seller gives up all rights of ownership at time of contract except for title.
- Requires clear written contracts that include how much of the annual (or monthly) payments go toward the purchase of the property and a schedule for purchase. This can be done with a “balloon” payment at the end, for instance.
- Contract must also clearly indicate what happens if the buyer is late on payments or otherwise defaults.
- If the buyer is an employee of the seller (or if the seller wants to recognize all the work the buyer has put into the property), the purchase price may be reduced through “sweat equity.” The buyer and seller agree on how to determine this (for instance, $1000 reduction in price for every year worked on the land or for the business).

Advantages:
- Buyer is able to slowly ramp up to ownership while also working the land and developing that asset (building soil fertility, planning out infrastructure, etc.).
- Buyers who aren’t able to secure a traditional mortgage can still purchase a farm.

Disadvantages:
- No “guarantee” for the seller if the buyer defaults on the payments (unlike the FSA program).
- If buyer is an employee, seller can fire the buyer and all sweat equity is at risk if agreement is not thorough.
- Fairly complex form of transaction to negotiate that requires time and expertise to arrive at equitable terms.
- If buyer does not make all payments in full, seller cannot foreclose and must go to court to retrieve title again.

5) FSA Land Contract Guarantee Program:

- Program administered by the U.S. Department of Agriculture's Farm Service Agency (FSA) that makes and guarantees loans to eligible farmers to buy and operate family-sized farms.
- Guarantees are offered to landowners who wish to sell through a land contract (see below) to a beginning farmer or farmer who is a member of a socially disadvantaged group.
- Purchase price must not exceed $500,000.
- Guarantee period can last up to 10 years.
- Buyer must provide a minimum of 5% down payment, operate the farm and be able to demonstrate the ability to make payments through cash-flow projections.

Advantages:

- The "guarantee" provides an incentive for landowners to sell to individuals who might not otherwise be capable of buying land; the guarantee reduces the financial risk to the seller due to buyer default on the contract payments.
- Interest rate is fixed and will not exceed the FSA's direct farm ownership loan interest rate by more than three percentage points.

Disadvantages:

- Buyer only has two payment options that the seller chooses: (1) "Prompt Payment Guarantee" that guarantees up to three installments per year plus the cost of taxes and insurance OR (2) "Standard Guarantee," which guarantees 90% of the outstanding principal balance.