



Policy Recommendations: Ways to Prevent Built-to-Fail Land Contracts and Lease-Options From Hijacking the American Dream of Homeownership

August 2024

Introduction

A significant number of Americans have attempted to become homeowners through “rent-to-own” transactions - either a land contract or a lease with option to buy. In 2022, the Pew Charitable Trusts conducted a nationwide survey of consumers who reported having ever borrowed money to purchase a home. The survey showed that out of the roughly 180 million people who had borrowed money to purchase a home in the United States, 6% of them (nearly 11 million people) had used a land contract, and roughly the same percentage had entered into a lease-option, at some point in time.¹

In healthy lending transactions, the loan terms are structured so that both the lender and borrower do better when the borrower succeeds. Yet in some credit markets, the interests of lenders and the borrowers diverge. Predatory lending occurs when lenders benefit from, or are indifferent about, the borrower’s inability to succeed in the transaction.

Land contracts and lease-option transactions often end in failure, with studies of public data showing early default rates of over 50%.² The reason is that the majority of these transactions are **built to fail**. The sellers in these transactions benefit more when the consumer defaults and can be evicted. When rent-to-own contracts fail, buyers lose their family home along with their hope for homeownership. They also forfeit their investment, which includes their downpayment or option fee, the monthly rent, the extra amounts they have paid towards the purchase price, and property taxes and insurance paid on the home. Often the buyers have made substantial repairs and improvements, leaving the home in better condition than when they moved in. Every time a buyer fails, the seller has another opportunity for profit, without even investing in another property.

Any attempt to regulate these transactions and reduce the harm they inflict must address this fundamental incentive problem. These transactions must be regulated to incentivize successful transactions and remove the windfall a seller obtains when homebuyers fail.

Background: Land Contracts

Land contracts (also known as contracts for deed) are a form of seller-financing in which the homebuyer promises to pay a fixed amount of money, at a certain interest rate, over a certain term (often 20 or 30 years). However, unlike conventional financing of homes, the deed to the home remains in the seller’s name until the buyer has paid the entire purchase price.³ If the buyer misses a single payment at any point during the term, typically the contract purports to allow the seller to cancel the contract and claim the borrower has “forfeited” the benefits of the contract. The seller then asserts that it is entitled to keep all the buyer’s payments under the contract, the value of all improvements made by the buyer, and any equity the buyer built up

over years of payments. The buyer then gets evicted like a tenant. This is known as the forfeiture remedy.

Often properties sold on land contracts are in terrible condition: they may be missing all necessary systems (including electric, plumbing, and heating), have major foundation issues or active lead hazards, or have pending vacate orders from the city government because they are considered uninhabitable. Lack of clear ownership of the home prevents buyers from accessing grants and loans for home improvement, making repairs more difficult. Consumers, lured by the promise of home ownership, spend hard-earned dollars and sweat-equity refurbishing these uninhabitable homes.

Land contract transactions have certain core features that put consumers at significant risk. First, the transactions are typically invisible in the public deed records, which means that contract buyers risk having their interest jeopardized by a later transfer or lien. The failure to record these transactions undermines the reliability of the public land records and the ability to convey good title to the properties. Second, the forfeiture remedy in land contracts creates a means of depriving contract buyers of all of their investment in the home, and any equitable interest in the home, without legal process and without a public auction of the home for highest and best value. The forfeiture remedy reflects the central unfairness of these transactions, in which contract buyers are told that they have all of the obligations of homeownership (including paying the property taxes and repairing and maintaining the property) but none of the legal rights or protections of homeownership.

While some state legislatures have attempted to address the core structural unfairness of the forfeiture remedy, other states have merely built up a framework for enforcing land contracts, including the harsh forfeiture remedy upon default, in ways that keep the land ownership records clear.⁴ Still others have chosen to require up-front disclosures or ongoing statements, providing information but no substantive protections to contract buyers. Even when the state legislature's intent is to provide safeguards for the buyers, a disclosure-only system can actually undermine protections that courts might otherwise create. For example, a disclosure law may have the effect of overruling judicial decisions that these transactions create "equitable mortgages," giving buyers some or all of the rights that protect mortgage borrowers.⁵

Background: Lease-Options

A lease-option transaction involves two contracts: a residential lease and an option to buy the property for a certain price within a certain time period, usually between six months and three years. Until the option is exercised, the consumer is a tenant. When the option is exercised, the consumer must obtain separate financing. At the time the contracts are entered into, the consumer makes a substantial payment for the option, usually ranging from \$3,000 to \$5,000 and sometimes significantly more. A primary reason that lease-option transactions are unfair is that the option price is often unaffordable, so consumers are unable to exercise the option and lose their option fee as a result.

The premise of an option fee is that the consumer is paying for the right to purchase the home at an agreed-upon price and for the landlord not to sell the home to any other buyer during the time period in question. However, often the home price is inflated, because there is rarely an independent appraisal or a home inspection prior to entering into the option contract. An option to purchase a home for substantially more than its fair market value is worthless, and no homebuyer in need of financing will be able to obtain a mortgage for more than the home's appraised value.

As with land contracts, the primary target audience for a lease-option is consumers who are not currently able to obtain a traditional mortgage. Yet these transactions require the consumer to obtain outside financing for the home purchase that was not available to the consumer at the inception of the transaction and is likely to be similarly unavailable when the option to purchase must be exercised.

Lease-option sellers generally mislead buyers into believing that renting the home for a period of time will improve their credit rating sufficiently so they will qualify for separate financing and be able to exercise the option. In reality, this almost never happens.⁶ Rental payment history is not reported to credit bureaus or factored into traditional credit scores; and the burden of making repairs and paying higher rent leads many consumers to default on the rental payments.⁷ If the consumer misses a rental payment at any time, the option to buy is forfeited, and the option fee is lost.

Too often consumers in a lease-option take on unreasonable burdens because they believe that they will soon own the home in question. They pay a large option fee and higher than average rents.⁸ They may also spend money on repairs pursuant to a lease agreement that puts the duty of all repairs on the tenant, which violates landlord-tenant laws in all but two states.⁹

Finally, it is important to note that some contracts titled “lease with option to buy” are really land contracts. Although most state laws on land contracts do not sufficiently protect consumers, some include just enough requirements to drive certain unscrupulous sellers to describe the transaction as a lease-option, even when it is really a land contract in disguise. The primary defining characteristic of a land contract is that at the end of the agreement, the consumer will have paid the full purchase price and should be entitled to receive a deed. A true lease-option should involve an expectation by both parties that there will be a separate transaction if and when the option is exercised. Nonetheless, contracts that operate in a legal gray area are common.

Policy Recommendations

Federal, state, and local lawmakers have tools to help prevent the worst abuses and create a marketplace that aligns the interests of sellers and buyers. The goal should be to change the dynamic in these transactions so that they no longer allow the seller to profit from the failure of the transaction, while causing devastating financial harm to the buyer. We urge federal agencies and local, state, and federal lawmakers to consider laws and regulations that will reward successful transactions and eliminate contracts that are built to fail, develop more data, improve the availability of traditional financing, and encourage enforcement of existing protections.

Federal Agencies Should

1. Define certain practices as unfair, deceptive, or abusive. **The Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC) both have authority over rent-to-own contracts. These agencies should issue regulatory guidance and take enforcement actions establishing that certain conduct in land contract and lease-option transactions is deemed unfair, deceptive, or abusive.**

The agencies should take the position that the following conduct in **land contract** transactions is unfair, deceptive, or abusive:

- **Using or enforcing a contractual term that causes the buyer to lose more upon default than they would have lost if they had been renting the home.** This would include a forfeiture clause allowing the seller to keep the value of the buyer's investment in the property, including the down payment, the option fee, extra amounts that the buyer pays toward the purchase price, and expenditures on property taxes, property insurance, repairs, maintenance, and improvements.
- **Using the land contract as a mechanism to evade requirements for the rental of habitable homes.** Selling an uninhabitable property through a land contract when state or local laws require rental properties to be habitable creates a substantial likelihood that the land contract transaction will fail because the *combination* of the monthly payment and cost of repairs is unaffordable.
- **Selling a property through a land contract when another lien puts the buyer's interest at risk.** This is the case when a lien exists prior to the land contract, or when the land contract is not recorded and a seller allows a lien to attach after the land contract was formed. The lien reduces the value of the buyer's interest when it is not factored into the purchase price. A lien puts the buyer's interest at risk when the seller does not make required payments on the lien.
- **Calling a transaction a lease-option when it is in fact a land contract in substance.** Sellers sometimes title the contract "lease with option to buy" simply in an attempt to evade applicable laws.
- **Using shell companies to evade protections.** This includes operating through multiple corporate entities to obscure the volume of the seller's transactions when that volume would trigger coverage of consumer statutes, as well as using corporate entities as the borrower in an attempt to evade consumer protection laws.

The agencies should clarify that the following conduct in **lease-option** transactions is unfair, deceptive, or abusive:

- **Selling a home through lease-option for a grossly inflated sale price.** A grossly inflated sale price makes it impossible for the consumer to obtain financing to exercise their option.
- **Using or enforcing a contractual term that causes the tenant-buyer to lose more upon default than they would have lost if they had been in a regular lease.** This would include a forfeiture clause allowing the seller to keep the value of the buyer's investment in the property, including the down payment, the option fee, extra amounts that the buyer pays toward the purchase price, and expenditures on property taxes, property insurance, repairs, maintenance, and improvements.
- **Unlawful lease terms related to habitability.** This includes representing in a written lease-option agreement that the tenant is required to make repairs necessary for habitability when such a contract term violates state or local laws. Any implicit or explicit representation that the tenant has the obligation to restore and maintain the property is deceptive.
- **Making claims of credit repair or improvement without affirmatively taking steps to improve the buyer's credit standing.** False claims of credit repair may also give rise to liability under federal credit repair laws.

2. Enforce federal consumer lending laws that apply. The CFPB should clearly articulate that the federal laws and regulations governing the financing of consumer dwellings, including the Truth in Lending Act and the Homeownership and Equity Protection Act, apply to land contract transactions. These laws require disclosures, prohibit pre-dispute arbitration clauses,

require verification of the buyer's ability to make the payments due under the contract, and give the buyer a three-day right to rescind the transaction.

The CFPB, the FTC, and state Attorneys General should dedicate significant resources to enforcement actions in this area. Many predatory actors are violating the law in the belief they will not be held accountable.

3. Gather comprehensive and reliable information about the extent of the problems caused by these alternative transactions. Agencies should seek to obtain data through supervision and enforcement regarding success and failure rates of land contract and lease-option transactions. Agencies should also solicit and compile information through consumer complaints and from legal services attorneys and housing counselors.

4. Expand opportunities for home ownership through small-dollar mortgages. One of the best ways to require (or at least incentivize) federally regulated or insured financial institutions to originate small-dollar mortgage loans. Opening up access to reasonably priced mortgages with fair terms would go a long way towards obviating the need for land contracts and lease-options.

5. Maintain non-performing note sale and Real Estate Owned (REO) disposition policies to maximize viable pathways to homeownership and prevent the funneling of homes into the hands of profit-driven investors. Fannie Mae and Freddie Mac's decisions to sell REO properties in bulk to rent-to-own sellers during the last foreclosure crisis led to such entities milking significant short-term profits from low-income people, disproportionately people of color, through a false promise of homeownership.¹⁰ Only after significant pressure did the GSEs adjust their REO-sale policies and note sale policies, and the safeguards in place still could be strengthened.¹¹ The Federal Housing Administration (FHA) is engaging in a rulemaking around its note sale process right now in which the proposed rule prohibits purchasers of non-performing notes from entering into contracts for deed, or from entering into lease-options without prior agency approval.¹² FHA should finalize this proposed rule. Any approval by the Department of Housing and Urban Development (HUD) of lease-options by note buyers should be conditioned on an entity designing a process that is built to succeed, with outcome data routinely provided to the agency.

Legislators and the local, state, and federal level should

Enact laws designed to increase the incentives for success and reduce the harms when contracts fail.

This should include:

1. Requiring use of the foreclosure process or the return of surplus equity. Requiring a creditor to carry out a foreclosure sale rather than a forfeiture as the remedy for default removes the potential windfall that an investor may receive by forfeiting the contract and keeping both the home and all monies paid by the buyer. Holding a public foreclosure sale also has the potential to bring a third-party buyer who offers a price close to fair market value. In a foreclosure, the creditor is only entitled to receive the remaining balance owed, and any surplus value above the amount owed would be returned to the consumer. Short of requiring foreclosure, another option is to require the return of money paid (or spent on repairs) by the consumer that exceeds the fair rental value of the home.

2. Requiring recordation of the land contract, with teeth. Requiring land contracts to be recorded creates conditions for success because it requires more effort for the seller to terminate the contract and evidence that termination through public records. It also protects the buyer's interest by putting the world on notice of the buyer's contract. Yet many states' laws requiring land contracts to be recorded have been unsuccessful. Iowa's statute sets forth a meaningful requirement: sellers who do not record the contract are prohibited from enforcing a forfeiture of the contract.

3. Requiring an independent assessment of value. To prevent sellers from grossly inflating the sale price, which is another marker of a transaction built to fail, sellers should be required to provide an appraisal and a disclosure of the price the seller paid for the home.

4. Requiring habitable conditions. Especially if forfeiture is permitted, it is essential to remove the windfall that sellers obtain by collecting payments on a home they would not be legally permitted to rent. Jurisdictions that have a certificate of occupancy for rental housing can expand this requirement to apply to land contracts (and make clear that it already applies to lease-options).¹³ In areas that do not have a habitability requirement for rental housing, requiring a determination by a licensed, independent inspector that the home meets the habitability standards of the nearest jurisdiction is a good alternative.

The [Preserving Pathways to Homeownership Act](#), S. 3720, sponsored by Senators Tina Smith (D-MN) and Cynthia Lummis (R-WY), would represent a significant step towards these goals, by establishing a federal requirement to record contracts for deed in the land records and to carry out a termination through foreclosure rather than forfeiture.¹⁴

Conclusions

The risks presented to consumers from “rent-to-own” home transactions are significant. There is no evidence that these transactions present a viable pathway to homeownership. To help would-be homeowners make progress towards the American Dream, we must focus on options that have a proven track record of success. Lawmakers have tools at their disposal to ensure that land contracts and lease-options are legally permitted only when they present a reasonable likelihood of success and minimal harm to those who do not succeed.

For more information, contact Sarah Mancini (smancini@nclc.org) or Margot Saunders (msaunders@nclc.org).

Endnotes

¹ Pew Charitable Trusts, “Millions of Americans Have Used Risky Financing Arrangements to Buy Homes” (Apr. 14, 2022), <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/04/millions-of-americans-have-used-risky-financing-arrangements-to-buy-homes>.

² Eric Seymour and Josh Akers, “Judged by their Deeds: Outcomes for Properties Acquired by Contract Sellers Following the Foreclosure Crisis in Detroit,” *Housing Policy Debate* (2024), available at <https://www.tandfonline.com/doi/full/10.1080/10511482.2024.2334859> (reflecting a conservative estimate of 53% early failure rate for large contract for deed and lease-option sellers and a 40-65% early failure rate for certain sellers known to be subject to litigation); Rebecca Burns, “Private Equity Sold Them a Dream of Homeownership. They Got Evicted Instead,” *Business Insider* (July 7, 2023) (for one nationwide lease-option seller, 54% of tenants had left the home and only 14% had successfully purchased the home); <https://www.insider.com/home-partners-rent-to-own-low->

success-rate-2023-5; Matthew Goldstein, "Divvy Wants to Make Rent-to-Own Deals Easy. Many Customers Find them Hard," The New York Times (Aug. 1, 2023), <https://www.nytimes.com/2023/08/01/business/divvy-homes-housing-rent.html> (reflecting 53% failure rate for large lease-option seller).

³ See, e.g., Jeremiah Battle et al., Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color, National Consumer Law Center (2016), available at <https://www.nclc.org/images/pdf/pr-reports/report-land-contracts.pdf>.

⁴ National Consumer Law Center, Summary of State Land Contract Statutes (Apr. 30, 2021), available at <https://www.pewtrusts.org/-/media/assets/2022/02/summary-of-state-land-contract-statutes.pdf>.

⁵ In a number of states, courts have treated land installment contracts as equitable mortgages. The result of emphasizing the substance over form of these transactions in this way can be that the rights normally provided to the borrower in a standard mortgage transaction are accorded to the buyer in a land contract. See, e.g., Thornton v. Marcum, 2008 WL 836368 (Tenn. Ct. App. Mar. 31, 2008) (applying doctrine of equitable estoppel to order specific performance of oral installment land sale contract after buyer had made regular payments for three years); Yarto v. Gilliland, 287 S.W.3d 83 (Tex. App. 2009) (enjoining eviction where defendant raised plausible title claim based on oral contract for deed that fell within exception to statute of frauds). See also National Consumer Law Center, Home Foreclosures Chapter 13 (2d ed. 2023), updated at www.nclc.org/library.

⁶ Rachel Cruze, "Rent-to-own Homes: How Do They Work and Is It a Good Idea?," Ramsey Solutions (Feb. 2, 2023), <https://www.ramseysolutions.com/real-estate/how-does-rent-to-own-work>.

⁷ See Chi Chi Wu, "Even the Catch-22s Come with Catch-22s: Potential Harms & Drawbacks of Rent Reporting," National Consumer Law Center (Mar. 6, 2024), <https://www.nclc.org/resources/even-the-catch-22s-come-with-catch-22s-potential-harms-drawbacks-of-rent-reporting/> (noting that rental history can be used to improve credit standing, but using bank account transaction data is the safest way to do this without causing unintended harms).

⁸ See Rebecca Burns, "Private Equity Sold Them a Dream of Homeownership. They Got Evicted Instead," Business Insider (July 7, 2023), <https://www.insider.com/home-partners-rent-to-own-low-success-rate-2023-5>; Matthew Goldstein, "Divvy Wants to Make Rent-to-Own Deals Easy. Many Customers Find them Hard," The New York Times (Aug. 1, 2023), <https://www.nytimes.com/2023/08/01/business/divvy-homes-housing-rent.html>.

⁹ Arkansas landlord-tenant law does not include duty of habitability on the part of landlords, and in Michigan the landlord may shift the duty to a tenant in a written lease of longer than one year.

¹⁰ Alexandra Stevenson, Matthew Goldstein, "Market for FixerUppers Traps Low-Income Buyers," The New York Times, Feb. 21, 2016, A1.;

<http://www.nytimes.com/2016/02/21/business/dealbook/market-for-fixer-uppers-traps-low-income-buyers.html>;

Alexandra Stevenson and Matthew Goldstein, "Rent-to-Own Homes: A Win-Win for Landlords, a Risk for Struggling Tenants," The New York Times, Aug. 21, 2016,

http://www.nytimes.com/2016/08/22/business/dealbook/rent-to-own-homes-a-win-win-for-landlords-a-risk-forstruggling-tenants.html?_r=0.

¹¹ Matthew Goldstein and Alexandra Stevenson, After Complaints, Fannie Mae Will Stop Selling Homes to Vision Property, The New York Times (May 23, 2017), available at

<https://www.nytimes.com/2017/05/23/business/dealbook/after-complaints-fannie-mae-will-stop-selling-homes-tovision-property.html>;

Federal Housing Finance Authority, Fact Sheet: Non-Performing and Re-Performing Loan Sale Requirements and Reporting Updates (June 22, 2023), <https://www.fhfa.gov/sites/default/files/2024-01/NPL-RPL-Fact-Sheet-June2023.pdf> (prohibiting note sale purchasers from entering into land contracts or lease-options unless the buyer is a nonprofit). See also Andrea Bopp Stark, Alys Cohen, Steve Sharpe, and Geoff Walsh, How GSE Note Sales Undermine Homeownership, National Consumer Law Center (Jan. 30, 2023),

<https://www.nclc.org/resources/report-how-gse-note-sales-undermine-homeownership/> (listing areas for reform of GSE note sale policies).

¹² Dep't of Housing and Urban Dev't, Proposed Rule on Federal Housing Administration Single Family Sale Program, 89 Fed. Reg. 57798 (July 16, 2024) (comment window open through Sept. 16, 2024).

¹³ See, e.g., Cincinnati Mun. Code § 870-03, available at <https://library.municode.com..>

¹⁴ Preserving Pathways to Homeownership Bill, S. 3720, 118th Congress (2023-2024), <https://www.congress.gov/bill/118th-congress/senate-bill/3720/text/is>.