Joe Answers Some Common Questions About Lease Option Deals

Hosted by*:* Joe McCall
Guest*:* Alana

Joe: Welcome. This is The Real Estate Investing Mastery podcast.

Joe: Hey everybody, how are you doing? This is Joe McCall. Welcome to The Real Estate Investing Mastery podcast. I've got a special little treat for you today. This is not a normal podcast, but I thought it would be really good for you. One of my students, Alana, posted a question in the Facebook group about some questions that she had regarding tenant buyers getting financing on their lease option deals. And I was trying to answer them on Facebook. Other people were trying to answer them, but we weren't really answering her question. And so I said, hey, listen, Alana, let's get on the phone and talk and if it's all right with you, I'll record our conversation. You can ask me your questions and I'll try my best to answer them and I'll answer them until you're satisfied with the answer. So anyway, it's a short little podcast here, about 25 minutes or so.

Joe: And Alana asked some really, really good questions and so I just wanted to include them here as a podcast. So if you're at all interested in lease options, I'd encourage you to listen because these are a lot of questions that people get. They're common questions when it comes to lease option deals. And so I'm hoping that by answering these questions from a student who's actually doing deals, you all would get some infrared inspiration, get some clarification on how some things works and some good stuff like that. Cool. So I also want to tell you real quick, if you want my book on how to, you want to learn how to do lease options, I want to encourage you to get my book. It's called Wholesaling Lease Options. Discover the fastest and easiest way to make money in real estate today. And you can get it for free at WLOBook.com, WLOBook.com.

Joe: It's free. You just pay shipping and handling. It's all killer. No filler. As I like to say, it's got all really good content. I show you how to do these deals. I talk about the different types of offers you can make the lease option sellers to sellers about lease option deals. I talk about different types of marketing. I talk about what to say and all that good stuff. So get my book right, WLOBook.com. It's free. We'll ship it out to you. Just pay shipping and handling. And I appreciate you all very much. And let's get onto the podcast. All right, we'll see you.

Joe: Hey everybody. Joe McCall here and I'm with Alana and did I pronounce it right?

Alana: No.

Joe: Alana?

Alana: Yeah.

Joe: I'm sorry. I'm really sorry. All right. So Alana had some good questions about getting tenant buyers financed, helping them get financing. When you put them into a lease option house, how do you get that money that applied that they put down towards their option deposit as their future down payment? Is that right, Alana?

Alana: Yes. Yes. Because the only reason I asked that, I know you recommend finding a broker who's well versed in that, but I have an existing broker. He's really, really good. I want to use him and continue using him. So I was seeing if, you know, if I can explain it to him because I like him, but he's more a traditional loan officer.

Joe: Sure, okay. Well let me preface all of this by saying you don't want to be the loan expert and you shouldn't have to explain anything to a loan broker, loan, mortgage mortgage broker, loan officer. They should be the one telling you how to do it, right? So whenever I've done any kind of deal, when I'm going to a title company or an attorney or a mortgage broker, I'm like, I want to do this. How do you recommend we do it, right? And so sometimes the title company will say, you can't wholesale properties. That's illegal. You can't double close. You can't do assignments, you can't. So you want to make sure you're asking the question to them with an open mind. And if they tell you you can't do it, then you need to find somebody else who tells you, you know what, this is how we can do it, right?

Joe: So just like and I've learned this, I have my realtors license, right? And one of the first things they teach you when you're going to school to get your real estate licenses. Don't ever pretend to be the expert in something that you're not. You know, if somebody asks you a question about getting mortgages, refer them to a mortgage broker. When someone asks you a question about foundations, you know, and or termites, refer them to the experts. And so it's important for you as an investor, first of all, to understand that you need to know how to do lease option deals, right? But you can't, you got to be careful with telling a mortgage broker how to do it because what if you're telling them the wrong way or something like that. So here's my first advice would be talk to the mortgage broker and say, hey, I heard this guy is doing this stuff.

Joe: How do you recommend we do it? Because if he's a good mortgage broker, he's going to be, well, you know what, let me figure that out. Let me find that out. And you could say this, well, Joe says that certain banks won't allow the option deposit money to be applied towards the down payment. Certain banks will, right. And I also sent you a link to that podcast that I did with the mortgage broker. Did you listen to this?

Alana: Yeah, I saw that.

Joe: So we talked about this whole issues very, very specifically then, right? Let me provide a little context, a little people that are listening as well, when a tenant buyer moves into a lease option house, they're going to write a check out for their option deposit money, and it's hopefully 3% to 5%, okay, of the price of the house, they're going to write that check out. I recommend you have that check go to an escrow company, then in one or two years when that tenant buyer is working with a mortgage broker, the mortgage broker and show the bank this check made out to a escrow account two years earlier and get that applied towards their down payment.

Joe: So it's all in how you present it to the bank in one or two years. Does that make sense, Alana?

Alana: Yes, it makes sense. Do you, I mean, are there nationwide banks that accept it like that or is it just for them to figure out? It just seems so vast to try to just, I don't know. To figure out what to do, you know, which nationwide banks do that?

Joe: No, I don't know, and I would be hesitant to recommend any because I really would prefer you to work with local mortgage brokers for one big reason. You want your tenant buyer to work with that mortgage broker, right?

Alana: Right.

Joe: I want my tenant buyers, if they're trying to get their loan, to be able to have them once a month, once a quarter, go to that mortgage brokers office and sit down with them and say, this is, these are the things I need to do to get my credit fixed to get a mortgage, you know, the mortgage broker can tell them, hey listen, you need to make sure you don't get alone on a car. Pay down these credit cards, make sure you get a new line of credit. Take care of this little deficiency judgment or something like that, right? You're just trying to get that big national bank. And the problem too is that there's very few of any big nationwide banks or mortgage brokers that are licensed in all 50 states.

Alana: Oh okay. That makes sense. So it's like what you said, don't ask, don't ask how… ask who, right?

Joe: That's exactly right, Alana. So you, it's important to still know the how, right? And that's why I created my course, but you still want to be sure you're not presenting yourself as the expert on how to do the mortgage side of the thing, right? Because you need to work with the mortgage broker. What is important is this, there's a few things that are really, really important. You find a good local mortgage broker that that is comfortable working with people who have challenged credit, people that need a little bit of credit repair so they can get their credit fixed and over the line you're want to make sure number two, that you're working only with tenant buyers that have a realistic chance of getting a mortgage in one to two years preferably a year or less, right? A realistic chance of getting a mortgage in one year or less so they have to be able to afford the home.

Joe: They need to be able to have to have a good debt to income ratio and credit needs to be where you know it's just a few tweaks here and there. They should be able, no guarantees. They should be able to get a mortgage in a year. The other thing is that's important, you want to make sure that initial and, and this only applies to lease option assignments, it doesn't apply to sandwich lease options, sandwich lease options it's okay if the checks made out to you, the investor on a lease option assignment, you want that tenant buyer to make a cashier's check out to a escrow company and your mortgage broker can help them find it so it could even be an attorney that can then you can show the bank in a year this money was made out to an escrow company.

Joe: Typically what happens is in a year when that tenant buyer gets ready to get a mortgage, the mortgage broker is going to help create a, on a lease option assignment deal, they're going to write up a new purchase and sale agreement between the tenant, buyer and seller. And it's going to be between them at that price that you were advertising it before. But not every bank will allow that money that they put down a year ago towards their down payment. Certain banks will, I don't know which banks will, which banks won't it just depends on the deal, but you need to rely on your mortgage broker to figure that out for you.

Alana: Got it, got it. And then let me ask you this, if it's, is it a matter of how you word it? Because I always imagine when it comes, you know, when the tenant buyer first signs on, they, you know, you get the nonrefundable option fee upfront and then in two years later or whenever it is time for them to fully cash out, it's like they're going to have to pay another type of down payment. And I just don't want them to be like, oh, didn't I already pay like a down payment towards the house. So you don't word the option fee as a deposit or a down payment. I've heard some things like that. Like you have to be careful of the way you word it and you can't use these words interchangeably. Is that correct?

Joe: So my contracts are worded right now where they don't guarantee that that money will be applied towards their down payment. All it does is saying it's going to be reduced from the price of the home.

Alana: Okay.

Joe: So if they, you know, if they don't use the bank, the mortgage broker that I tell them to use and they try to go to their own Bank of America or wells Fargo or whatever to do it. Nowhere in the contract is it guaranteeing that that money will go towards the down payment. I'm saying that it goes to reduce the price of the home. So in technical terms, really they're just buying the option to buy the property.

Alana: I like the way you just put it, like there's no guarantee that the down payment that comes off the purchase price, but it doesn't necessarily go towards a down payment. I think that just made it click.

Joe: All right. Anything else, Alana?

Alana: Yes. If it comes, I know that part of the part of the draw for a seller selling it on selling their house on a lease option is to be able to get close a full price or close to full price offer when they otherwise may not. So my question is this, if you price it and you do the contract and you know, you do everything at the top of the market and then say the house doesn't appreciate quite as much, say you're a little bit shy. Say you did the contract with the tenant buyers for like a $100,000 but the house only appraised for $92,000, then what then is it they have to, the seller has to reduce the price or what happens if that happens?

Joe: A couple of things. Nobody can predict what the market's going to do in one or two years, right. You can't predict when it's going to go up, be flat or it's going to go down. It may, we may have a huge recession, we may get bombed, you know, we may go to war and the economy goes to crap. So nobody can predict what the market's going to do in the future. So don't feel like you have to be, you have to predict what the market's going to do. Do you need to be within the best reason that you can. What I like to do is I will set the option price in one or two years at today's price, plus maybe 3% to 5%. So you can charge a premium. Just like, you know, if you were to sell a house, you could charge a premium if that house had granite countertops, if it had a pool in the backyard, and if it had irrigation, if it had, you know, really high end finishes, marble floors, you could charge a premium for that.

Joe: Well, it's the same with selling a house on a lease option. When you sell a house with creative terms, you can charge a premium on that. Not something extravagant and crazy, but you can charge a premium.

Alana: Absolutely.

Joe: So 3% to 5% is a good premium from today's current market value. So if a house is worth $100,000 thousand a day, I'm probably not going to sell it for more than $105,000 in a year or two from now, right? So it's reasonable. No judge can look at you in two years and say, hey listen, that house was worth a $100,000 thousand two years ago and now it's worth $80,000 and you are trying to sell it for $120,000, that's unreasonable. You understand?

Alana: Yes.

Joe: So that that you want to, you can show them, and this has happened to me before, the same exact thing that you're talking about. I did a lease option right at the height of the market. The market crashed and the house I was selling for at current market value back then was worth $20,000 or $30,000 less today. The tenant was trying to sue me, but nothing ever came of it because we showed them, I could even show them on Zillow the, you know, how Zillow has that chart that shows past prices and future predictions or whatever. And I can show them, okay, on this date it was here and that was what the value was and now it was here.

Joe: So what I did also at the time, because I, when I'm looking at comps on a property, I saved all of the comps. I printed PDFs on my computer of all of the comps at that time to show that the house was really actually worth $100,000, $105,000 two years ago. And so when I showed the attorney of that tenant, all of this proof that I have the back then it was worth that nobody could've predicted the market was going to crash like it did.

Alana: Right.

Joe: Nothing ever came of that, right? So here's my point and to answer your question, if the costs go down, you can't be liable or held liable for anything like that. What I tell the seller is, and if this is an assignment and I'm not in the deal anymore, but I tell the seller and the tenant buyers this, listen, we're going to set the option prices at $105,000 okay? If for whatever reason it doesn't appraise for $105,000 what I'm going to recommend Mr. Seller, is that this tenant, they've been paying on time, they've been taking care of the house. You know, you should just extend the lease option another year until it does appraise. So you have a couple options. You can keep on extending it until it does appraise or you can negotiate your price and lower it down. So sometimes in my contracts, I do give the tenant buyer an automatic extension.

Joe: I do tell them, I said, listen, if it doesn't appraise, we'll go ahead and automatically extend it another 12 months. So it's up to you if you want to add that into your contract, if you're concerned about that, you could add it in there. As long as the seller understands like, listen, you know, I'm a little nervous about this price. We're a little aggressive with it here. Like this is another example. The house is worth $200,000 today. Seller wants to sell it for $225,000 that's maybe a little too much, right.

Alana: Right.

Joe: I'll tell the seller, I said, all right, listen, we're going to do this, we'll sell it for $225,000 but I'm going to put a clause in my lease option contract that says if it doesn't appraise for $225,000 this tenant buyer gets to automatically extend it every year until it does appraise. Usually the seller doesn't have a problem with that.

Alana: Right, okay. That makes sense. I just wanted to know what was the options if that scenario and yeah, all that stuff. All those points you made are valid. Nobody knows. Thank you so much graciously for answering those questions. I guess my last and final question I have is, you know, I downloaded REI Simple. I have everything set up. I have my leads that I import into the CRM and I like it. You know, I have my documents, I know how to generate contracts and so on. So my question is this, what is a good workflow?

Alana: So leads come in, you text them that intro text the same day saying like, hi, I saw your house. Is it available? Are you the owner? Now once you go down into lease options and they say no. If you say, oh, would you consider rental own for a little while and then selling, and they say no, then do you reach up with them back in another month, two months, leave it alone. Like sometimes I get these leads and I'm like, I don't know how long to follow up without being a pest, you know?

Joe: Well first of all, don't worry about being a pest. We did 58 deals last year, okay. We were looking at the numbers of the day. In 2018 we did 58 deals, 58 deals, 54 came from the follower.

Alana: Wow.

Joe: 54 came from people that said no at the beginning.

Alana: Wow.

Joe: Some of those were, most of them are traditional wholesaling deals. We're doing this with a student in Alabama, but even with lease options, even more with lease options, most people are, they don't and maybe not heard of it, they'd not thought of it before. They're going to say no. And so we just follow up with them.

Depending on their motivation. If they're like on a scale of 1 to 10 if there are one, not remotivate, it all might follow up with them once a month. If they're a five or six or seven, we might, you know, they're open to the idea.

Joe: We might follow up with them every couple of weeks, every one to two weeks depending on what's going on. But you always want to follow up with every one of them. And so what I like to do in REI Simple is a couple things. You know there's the five-star rating in there. You could use that as the motivation rating if you wanted. So a cold call you give one star and then a, you can do a three star for a warm and a five star for a hot lead. But then what's really important is you got to change the status to follow up. You know, and you could even have a status for follow up cold follow up, warm follow up hot.

Alana: Yeah I do.

Joe: All right. Then what you could do is what I recommend is create a new task, okay? Create a task. If it's a hot lead or a warm lead out, create a task in a couple of weeks to call them back. All right? Then just move on to the next one because then in two weeks, that task is going to pop up in your calendar and you're going to look at the lead and you're just going to send them a text. You could call them if you wanted, you could do a sly dial if you wanted, whatever, and you could just follow up with them and say, hey, you know how you doing? Have you sold the house yet? How's the tenant working out?

Joe: If it's a seller that just put a tenant in the house, I might call them. I might set a task to follow up with them in two months, right? How's the tenant working out? Do you have any interest in selling the house, do you have any other rental properties that you'd like to sell, right.

Alana: Because you know I was putting those people on a year cause I figured that they're in a year lease, they're locked in a year lease with a tenant. But that's interesting.

Joe: Yeah, you've got to follow up with them more often than that, right. And it could just be, hey, do you have any other properties that you'd like to sell? Do you know anybody who's got some houses they'd like to sell, how's the tenant working out? Hopefully they're working out great. You know, if you ever change your mind, if you decide you want to sell or you know, please contact me. I'd love to talk with you, right. Also, this is important is that once a month I would take all of your old leads and download them and send them a postcard or a letter. Take all your old leads, you know, you should be able to download the owner's mailing address and the property address, right? Just send them a handwritten postcard or a letter or something saying, hey, this is Alana.

Joe: If you don't remember me, we talked a few awhile ago about your property at one, two, three main street. Just calling up. I mean, just following up, if you have any interest in selling, I'm still interested in buying or if you have any other properties you'd be interested in selling, please call me. Thanks a lot. Have a great day. Something simple like that.

Alana: Gotcha, gotcha. That sounds great. That sounds great. And what I wanted to ask you is, you know that the one, I have one property right now that I have, you know, on a lease option for a two-year term. That's the one that I was doing the whole Airbnb thing with. Now it's going good because it's cash flowing nicely every month. Now towards the end of the term, I'm kind of like, I kind of came in without an exit. So it's on Airbnb now and you know, there's listings, there's guests there and everything, it's great.

Alana: But when it comes time to cash out, I'm like, do I just put it on the MLS with like a flat fee broker or because I wouldn't have had a tenant buyer in there that's going to qualify. I didn't really look so far ahead, but now I'm like, you know, I'm like gee, I got to think about that.

Joe: Well first of all, big pat on the back. Congratulations for taking such massive action. Your first lease option deal, you turned it into an Airbnb and you negotiated with the seller to keep the furniture there, right?

Alana: Yeah. Because he staged it to make it look good and it just wouldn't sell no matter if he staged it or not. So yeah, I got lucky I think.

Joe: So awesome. So anyway, what I would do then is you have a couple different options and that's a great thing about lease options, right? Like you don't want to, you can just walk away from the deal at the end and say, you know what, here you can have it back. But you have a couple options? I would think of talk to the seller and try to negotiate an extended out and say, hey, this has been going great. Can we do another couple years? See what they say. Is there much equity in the house?

Alana: No, I have it under contract for $148,000 and recently a house around the corner appraised at $157,000.

Joe: Okay. So there's not much equity in it so it wouldn't make any sense to list it on the MLS and try to double close on it, right.

Alana: Right. But it would, it would, I would be able to say there was within my contract, I would be able to put it on the MLS and forego the whole tenant buyer waiting in there, right?

Joe: I'm sure you could, but look at the numbers, right. If you, I don't remember exactly what you said, but if you sell it for $155,000 and you, I mean, your contract is $148,000, you barely have enough money to pay the commissions.

Alana: To pay the commissions right. No, I meant like if it was in a case where there was more equity, I would be legally allowed to just put it right on the MLS and list it, right?

Joe: For sure. Yeah.

Alana: With our contracts, okay.

Joe: There's different ways to do it, and this goes back to the original questions, you'd have to talk to your nest grow or title company and say, hey listen, this is what I got. I've got the sandwich lease option. I got this contract with the seller to buy it here and you know this round numbers. Let's say I got a contract to buy it for $145,000 I think I can sell it for $185,000 and I have six months left in my option period.

Joe: I want to list it on the MLS and sell it. What would you recommend that we do? How do you recommend that we do this? There's a couple different ways and depending, if the title company is investor friendly and they understand this, they could say, well, you know, let's you have, I don't remember the numbers. Let's you have a $35,000 spread in there. What you could do, one of the things you could do is you could record a $35,000 lien on the property so that when it does, when you do sell it on the MLS and you've got to make sure the sellers on the same page with you and they should be, you know the buyer, you bring on the MLS, we'll contract with the sellers so you'll be removed, but you'll be paid on the HUD from satisfying the lien. Or the title company may say like I've used this, not me actually, some of my students have used this, they have a title company, in Illinois and the title company, but they prefer to call it a revocation of options so you record the option in the county and on the HUD.

Joe: Just call it a revocation a revocation of option. That option agreement. Right. I've had title companies telling me before, we'll just send us an invoice. Whenever your profit is on the deal, get the seller to sign it, you sign it, send us the invoice and we'll pay it. So kind of depends on like if the person buying it, is a cash buyer? If they're trying to get FHA financing, if there's a 90 day seasoning rule with FHA or whatever and you know they're, the title company would tell you the best way to do it. You may need to take title for 90 days.

Alana: Wow.

Joe: To sell it. So there's different, there's three or four different ways to do it. You just got to find a good title company that understands what you're doing. They understand lease options and they're a little more open to some creative things and then they will tell you, well, you know, let's do it this way.

Joe: Let's try to do it this way. Just make sure you're doing that in enough with enough advanced time, right.

Alana: Right.

Joe: Makes sense?

Alana: Yes, that makes sense.

Joe: Maybe with the seller, you might go back to the seller and say, listen, can we do this some more and I'll share, I'll split my profits with you. Let me continue doing this and I'll give you 25% of whatever my profits are. Maybe you could even negotiate with the seller a lower rent to him and you continue doing the Airbnb on it for another two, three, four, five years and now split the profits with the seller. That makes sense?

Alana: Yeah, that makes sense. And I had a seller actually tell me that he, on another note, I had a seller tell me that he wanted the price to him to be the future appraised price. And that kind of threw me for a loop because I didn't know they were so not sophisticated, but I just didn't expect that. I asked them, how can I put it under contract on another deal? And he said, well put it under contract for the future appraised price, right.

Joe: You should have asked them, well what if the future appraised prices $100,000 less than what it is today?

Alana: Right. I did. And I said that that doesn't protect you. Suppose it's less what they wanted to do, either this or higher, you know, like the future appraised price or like this, like a number or whatever, the higher of the two.

Joe: Yeah, that's a good common, that's a common objection that you get a lot from sellers and higher appreciating markets. So sometimes what I'll do is I'll say, let's do this. We'll split it down the middle. So if the house is worth $400,000 today and it's going to be worth $450,000 in two years, let's set the option price at $425,000 so the tenant buyer gets half the appreciation and you half of the appreciation. Would that be fair? And usually that's fine. So write that up, you could write it up that way. You know, you because that tenant buyers got to have some incentive to want to pay.

Alana: I just thought that was so unfair. I thought their incentive was a locked in price today and locking other buyers out.

Joe: You know, it could just mean that seller is not motivated enough yet, right. And you just, you might just need to pull away and pull back and say, you know, this doesn't sound like this is going to work out for you. And that's totally fine, right? But this is the way you have to be like strong enough to say like, this is the way we do it. This is the way it's going to have to happen. And you can go no, that's fine. You should probably just list it with a realtor and sell it. Why don't you just sell it right now? I can refer some realtors to you if you want and you know.

Alana: Posture.

Joe: No. Yeah. It's all about positioning and pulling back. Not chasing them, but pulling away and then if he's motivated, he or she, if they're motivated, they, you know, they'll do it. So sometimes it's a stall tactic or they're just saying, you know what I'm not really comfortable yet with doing it this way.

Alana: Right.

Joe: Does that make sense?

Alana: Yeah. That makes total sense? I just didn't know, like what's the approach? But yeah, it sounds like they're not motivated indeed. Because I thought of, you know, splitting the equity even 60/40, just to get like the deal.

Joe: Yeah. Well, you know, it kind of depends on if there's cashflow in it or not, right. Maybe give them the higher price, if they give you the lower rent and you can get, instead of $300 a month cashflow, maybe you can get $700 or $800 a month in cash low.

Alana: Yes, exactly. And I said, I tried to say, well, the tenant buyers payment is not going towards the principal, so can that account for some of the, you know, for some of the appreciation that makes sense.

Joe: Yeah. So get some kind of rent credit from the seller. Sure.

Alana: Got It. Got It. Got It. Awesome.

Joe: Alright, Alana.