The Recent Reemergence – And Risks to Buyers – Of Renting-to-Own Home Contract Sales

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The U.S. housing crash and subsequent recession were cataclysmic events in the United States – and they led to the foreclosure crisis that left banks with a glut of empty homes. Investors took advantage of the crisis by purchasing large numbers of foreclosed single-family properties, often in the same areas. Investors in these spatially concentrated homes are now following profit-generating strategies such as contract-for-deed sales that are often packaged as "rent-to-own" programs. Well-known sellers using this strategy include Harbour Portfolio, which owns more than 6,000 properties across the country, and Vision Property Management, which is estimated to own more 5,500. Both companies have recently come under legal scrutiny and face suits that contend their practices are predatory, deceptive and discriminatory.

What is a Contract Sale?

Contract sales differ from conventional property sales in several important ways:

- Contract sales do not involve traditional mortgages, because the seller both sells the property and provides the buyer with a loan.
- Contract sellers charge interest rates well above the rate of a typical mortgage, and the contracts often have punitive terms.
- The buyer does not take possession of the deed until the contract is fully paid off, yet buyers are typically responsible for all property taxes, the property's maintenance, and insurance.
- Contract sellers can easily evict buyers who fall behind on payments, without going through the normal foreclosure process.

Contract sales are often more expensive than a traditional mortgage, generating substantial profits for sellers. Although the average interest rate for a conventional mortgage has been 5% in recent years, a *New York Times* investigation found the interest rate for dozens of Harbour Portfolio contract sales was 9.9%. In examining the activity of Harbour in the Atlanta area, Georgia State University urban studies researcher Dan Immergluck estimated that the effective interest rate on an average sale could be above 28%. My own research has identified similarly profitable contact sales. In one example, a company called Battery Point Financial bought a property from Fannie Mae for just $48,000, and then turned around and sold it on contract for a sale price of $111,000. Under the terms of the contract, the buyer had a $2,500 down payment and agreed that the remaining $108,500 would be paid off over 20 years with an 8.75% interest rate.

In addition to paying high costs, buyers in contract sales are responsible for property taxes and any repairs the property may require. Some contracts even stipulate that buyers have to pay any delinquent property taxes owed by a previous owner. Buyers sometimes do not fully understand the terms of agreements and the associated costs until after they have signed the contract – which can result in them having to pay substantially more than planned. What is more, the terms of these contracts leave buyers vulnerable to eviction; in fact, some of these contracts stipulate that a buyer can be evicted for a single missed payment. If a buyer is evicted, the contract seller keeps the property along with the down payment and all payments already made. The seller also benefits from any repairs made to the property and is free to re-sell the property to another buyer.

Throughout the 20th century, inflated prices, high interest rates, and punitive terms meant that many households that bought on contract failed to ever finalize ownership of the properties. And buyers often lost considerable wealth in the contract buying process. In Chicago alone, contract sales resulted in about $1 million dollars per day drained from black communities. The prevalence of contract sales waned after the passage of the 1968 Housing Act and 1974 Equal Credit Opportunity Act, but legal aid groups and journalists have noticed a resurgence of such sales since the 2007-2009 recession.

How Widespread is Contemporary Contract Selling?

Given the high cost of contract sales and the vulnerabilities they create for buyers, it is important to know the scope and of this practice and the affected locations. In his recent study of one contract seller in the Atlanta area, Dan Immergluck found that Harbour Portfolio's activity was concentrated in black neighborhoods. A federal lawsuit also claims that Harbour specifically targets African-Americans and offers contracts designed to fail. Because Harbour is just one seller, it may not be representative contract selling overall.

A lack of regulation and the fractured nature of property records make it difficult to pin down how widespread contract selling is today. The use of limited liability companies and limited partnerships can make it challenging to identify all the properties owned by a single operator. For example, I have found 23 different entities tied to Vision Property Management, with names ranging from Kaja Holdings to Mo Seven. Identifying properties owned by contract sellers requires first knowing all of the affiliated limited liability and partnership names.

Another barrier is that many states do not require contract sales to be recorded. The state of Illinois did not institute such a requirement until January 1, 2018 – and its law only applies to subsequent sales, leaving contract sales that took place before that date unrecorded and unknown. Enforcing this new law also requires knowing who contract sellers are, which as previously discussed can be a difficult task. Many states that require contract sales to be reported have lax enforcement.

Lawmakers and researchers alike, in short, have much to do to gain realistic information about the prevalence and targeting of contract sales – as well as a better understanding of their possible harmful effects on buyers and communities. Passing laws that require contract sales to be recorded is a good first step – but it must be followed by vigilant enforcement and much more analysis by independent researchers.

Read more in Ralph Martire, Amanda Kass, and Bobby Otter "A Fiscal Review of the Chicago Housing Authority" *Center for Tax and Budget Accountability* (published online, July, 2014).