

ADVISORY REGARDING LEASE OPTION

1 The following Summary¹ is intended to briefly address some of the practical and legal issues which may arise when buyers and sellers enter into an
2 Option Agreement or an Option Agreement coupled with a Rental or Lease Agreement. This Summary is not intended to be a complete explanation
3 of the topic and does not constitute "legal advice." In most cases, sellers entering into Option Agreements will have liability for a commission.
4 Sellers and buyers considering entering into an Option or Lease-Option Agreement should each secure separate legal counsel.

5 **1. DEFINITION:** Simply stated, an option is nothing more than an agreement by an owner to sell a property to a buyer for a fixed purchase price.
6 The offer remains locked in at the fixed price for a certain period of time, during which the buyer can "opt" to buy the property for the agreed price –
7 or walk away with no further obligation. During the option period, the seller cannot, without buyer's consent, revoke the offer, change the price or
8 any of the agreed-upon terms, or sell the property to someone else. Obviously, there is value to a potential buyer to have this ability to unilaterally
9 buy or not buy, and for this right, the parties must agree upon the consideration – that is the price for the option, which is normally paid at the
10 commencement of the transaction. An Option Agreement differs from a Sale Agreement in several ways, but one of the main differences is the
11 option consideration paid by the potential buyer is nonrefundable (assuming the seller doesn't default under the Option Agreement), regardless of
12 whether the buyer decides to purchase or walk away. If the option is not exercised by the buyer within the agreed-upon time period, then the right
13 of purchase for the fixed price expires, and the option consideration is retained by the seller.

14 **2. RISKS:** There are risks in entering any legal contracts, such as Sale Agreements, Leases, Option Agreements, etc. It is for this reason the use of
15 legal counsel or a lawyer-reviewed form is always recommended. What follows is an abbreviated list² of issues for consideration when negotiating
16 options or lease options.

17 (a) If the seller's property is encumbered by one or more loans, there is a high likelihood the lender's document(s) contain one or more
18 restrictions against transferring possession (including by rental or lease) and/or transferring or selling option rights. Almost all loan documents
19 today contain what are generally referred to as "due-on-sale" clauses. These clauses are often broadly written and may significantly limit an
20 owner's ability to legally sell, lease, mortgage, or otherwise transfer any interest or possession in the property without the lender's express
21 consent. This leaves buyers and sellers with two alternatives: (i) Seek permission in advance from the lender; or (ii) Enter into the transaction
22 without seeking the lender's consent. Obviously, the second alternative is highly risky, as the loan balance could be accelerated, making it
23 immediately due and owing.

24 (b) Another risk related to the first one is where the buyer/renter makes rental payments for the property, but the seller fails to make the
25 underlying loan payments - thus creating a risk the property could be foreclosed, and the buyer/renter would lose the home and option money.
26 One way to deal with both of these risks (a and b) is to secure a copy of a current title report (not necessarily a title insurance policy) and
27 obtain from the seller written documentation of the underlying loan(s) and the payment history demonstrating the loan is current and not in
28 default.

29 (c) If the title report indicates the existence of deed restrictions, easements, or an owner's association (for example, for a property allocated in
30 a condominium, townhome development, or a planned community – all of which may have common areas, owner associations, and periodic
31 assessments) it is important for the buyer to review the contents of the association documents, minutes, report and finances. Also, many
32 association rules and by-laws have limitations or prohibitions on the rental and use of the property.

33 **3. RENTAL AND LEASING ISSUES TO CONSIDER:** It is important to remember buyers taking possession under a Lease or Rental Agreement³
34 are legally "tenants" with all the rights, duties, and liabilities granted under ORS Chapter 90, Oregon's Residential Landlord-Tenant Act ("ORLTA").
35 This is also true for sellers who become landlords – under ORLTA, landlords have certain legal duties and liabilities, such as being responsible for
36 assuring that the premises is "habitable."⁴ Significantly, sellers who become landlords may no longer access the property with the same ease as
37 they did before entering into the Rental or Lease Agreement.⁵ Except in the case of emergencies, 24-hour advance notice is usually necessary.
38 One of the more troublesome aspects of the Lease-Option Agreement is addressing the tenant's rights if he or she is in violation of the Rental or
39 Lease Agreement itself – for example, for failure to pay rent. Can the tenant/buyer exercise the option if they are in default? Some eviction courts
40 allow tenants with an option greater legal rights than tenants without one.

¹ Although this summary will refer to the parties as "buyers" and "sellers," this is for ease of reference rather than pure technical accuracy. One who grants an option is legally known as the "optionor" or "grantor" and the recipient is legally known as the "optionee" or "grantee." Only if the option is exercised does the optionor become the "seller" and the "optionee" become the "buyer." And, if there is a rental or lease agreement coupled with the option, the "seller" is also a "landlord" or "lessor," and the "buyer" is a "tenant" or "lessee." As discussed briefly above, each designation carries with it significantly different rights and obligations.

² This list does not purport to be complete. Your own legal counsel should be consulted for a more complete explanation.

³ Leases are usually for a fixed term, for example 12 months, after which time they automatically terminate; while rental agreements are usually month-to-month tenancies – that is they continue indefinitely until the landlord or tenant gives the other party a written 30-day notice of termination.

⁴ ORS 90.320

⁵ ORS 90.322

Buyer Initials ____ / ____ Date _____

Seller Initials ____ / ____ Date _____

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OREF C-543 | Page 1 of 2

ADVISORY REGARDING LEASE OPTION

41 **4. NEGOTIABLE ISSUES:** There are several issues which need to be included in the option in order for it to be enforceable.⁶ Here is another
 42 abbreviated list of points to consider:

- 43 • Will the option be recorded? Most experts agree the answer is "Yes." Otherwise, the seller could transfer or refinance the property without
- 44 the buyer's knowledge or consent, which could seriously jeopardize the buyer's rights upon exercise of the option.
- 45 • How long will the option remain open?
- 46 • How much should the option consideration be, and will it be applied to the purchase price if exercised?
- 47 • What will be the price and terms of the sale? How will the price be determined?

48 **5. PROPERTY DISCLOSURE:** The property will likely trigger Oregon's Seller's Property Disclosure law at some point⁷ But when should the
 49 disclosure form be given? One approach may be for the seller to give the disclosure form at the commencement of the lease-option transaction with
 50 a right of revocation at that time (that is, before the buyer has paid a nonrefundable option price) and then agree if the buyer exercises the option,
 51 the revocation period will not later apply.⁸ All of these issues should be addressed in writing, so there is no confusion later in the transaction.

52 **6. USE OF EXPERTS:** Option Agreements can be complicated, raising important legal issues. Your real estate agent is not an expert in these
 53 areas. Buyers and sellers are strongly encouraged to each secure separate legal counsel before entering into an Option or Lease-Option
 54 Agreement.

55 **ACKNOWLEDGEMENT:** The undersigned acknowledge they have read and understand this Advisory and have been provided with a copy for their
 56 own files.

57 Buyer _____ Date _____ a.m. _____ p.m. ←

58 Buyer _____ Date _____ a.m. _____ p.m. ←

59 Seller _____ Date _____ a.m. _____ p.m. ←

60 Seller _____ Date _____ a.m. _____ p.m. ←

61 Buyer's Agent _____ Seller's Agent _____

⁶ Generally, the legal rights and duties in most standard form Rental and Lease Agreements are substantially the same. The primary issue for the parties is the amount and date of the rental payments. Accordingly, this Summary does not address many of the terms found in these standard forms, since they cannot vary too far from what already exists in the ORLTA.

⁷ ORS 105.462 – 105.490

⁸ Oregon law permits buyers to legally waive the right of revocation, so long as it is done "at or prior to entering into a sale agreement." See, ORS 105.464.