

## ADVISORY REGARDING LEASE OPTION

The following Advisory Regarding Lease Option (this “Lease Option Advisory”)<sup>1</sup> is intended to briefly address some of the practical and legal issues which may arise when buyers and sellers enter into an option agreement or an option agreement coupled with a rental or lease agreement. This Lease Option Advisory is not intended to be a complete explanation of the topic and does not constitute “legal advice.” In most cases, sellers entering into option agreements will have liability for real estate compensation. Sellers and buyers considering entering into an option or lease-option agreement should each secure separate legal counsel.

**1. DEFINITION OF OPTION AGREEMENT:** 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. 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 or walk away with no further obligation. During the option period, the seller cannot, without the buyer’s consent, revoke the offer, change the price or 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 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 commencement of the transaction. An option agreement differs from a sale agreement in several ways, but one of the main differences is the option consideration paid by the potential buyer is nonrefundable (assuming the seller doesn’t default under the option agreement), regardless of 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 of purchase for the fixed price expires, and the option consideration is retained by the seller.

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<sup>1</sup> Although this Lease Option Advisory 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.

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## ADVISORY REGARDING LEASE OPTION

**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 legal counsel or a lawyer-reviewed form is always recommended. What follows is an abbreviated list<sup>2</sup> of issues for consideration when negotiating options or lease options.

(a) **Encumbrances.** 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 restrictions against transferring possession (including by rental or lease) and/or transferring or selling option rights. Almost all loan documents today contain what are generally referred to as "due-on-sale" clauses. These clauses are often broadly written and may significantly limit an owner's ability to legally sell, lease, mortgage, or otherwise transfer any interest or possession in the property without the lender's express consent. This leaves buyers and sellers with two alternatives: (i) seek permission in advance from the lender; or (ii) enter into the transaction without seeking the lender's consent. The second alternative is highly risky, as the loan balance could be accelerated, making it immediately due and owing.

(b) **Foreclosure Risks.** 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 underlying loan payments - thus creating a risk the property could be foreclosed, and the buyer/renter would lose the home and option money.

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

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

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## ADVISORY REGARDING LEASE OPTION

**3. RENTAL AND LEASING ISSUES TO CONSIDER:** It is important to remember buyers taking possession under a Lease or Rental Agreement<sup>3</sup> are legally tenants with all the rights, duties, and liabilities granted under [ORS Chapter 90](#), Oregon's Residential Landlord-Tenant Act ("ORLTA"). This is also true for sellers who become landlords; under ORLTA, landlords have certain legal duties and liabilities, such as being responsible for assuring that the premises is "habitable."<sup>4</sup> Significantly, sellers who become landlords may no longer access the property with the same ease as they did before entering into the Rental or Lease Agreement<sup>5</sup>. Except in the case of emergencies, twenty-four (24) hour advance notice is usually necessary. One of the more troublesome aspects of the lease-option agreement is addressing the tenant's rights if they are in violation of the Rental or 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 allow tenants with an option greater legal rights than tenants without one.

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

(a) Will the option be recorded? Most experts agree the answer is yes. Otherwise, the seller could transfer or refinance the property without the

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<sup>3</sup> Leases are usually for a fixed term, for example twelve (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 thirty (30) day notice of termination.

<sup>4</sup> [ORS 90.320](#).

<sup>5</sup> [ORS 90.322](#).

<sup>6</sup> 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 Advisory 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.

## ADVISORY REGARDING LEASE OPTION

buyer's knowledge or consent, which could seriously jeopardize the buyer's rights upon exercise of the option.

(b) How long will the option remain open?

(c) How much should the option consideration be, and will it be applied to the purchase price if exercised?

(d) What will be the price and terms of the sale? How will the price be determined?

**5. PROPERTY DISCLOSURE:** The property will likely trigger Oregon's Seller's Property Disclosure law at some point<sup>7</sup>. But, when should the Seller's Property Disclosure Statement be given? One approach may be for the seller to give the Seller's Property Disclosure Statement at the commencement of the lease-option transaction with 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, the revocation period will not later apply<sup>8</sup>. All of these issues should be addressed in writing, so there is no confusion later in the transaction.

**6. USE OF EXPERTS:** Option agreements can be complicated, raising important legal issues. Real estate agents are not an expert in these areas. Buyers and sellers are strongly encouraged to each secure separate legal counsel before entering into an option or lease-option agreement.

**7. ACKNOWLEDGMENT:** The undersigned acknowledge they: (a) have read and understand this Lease Option Advisory; and (b) have been provided with a copy for their own files.

Client \_\_\_\_\_ Date \_\_\_\_\_  a.m.  p.m. ←  
Print Name \_\_\_\_\_

Client \_\_\_\_\_ Date \_\_\_\_\_  a.m.  p.m. ←  
Print Name \_\_\_\_\_

<sup>7</sup> [ORS 105.462 – 105.490](#).

<sup>8</sup> 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](#)