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housing initiative

Rent to Own the American Dream

The Promises and Perils of Alternative Home Financing

November 2022

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Key Takeaways

- In the face of an inaccessible housing market, would-be homeowners are turning to alternative home financing options such as rent-to-own; researchers estimate that 36 million buyers have purchased homes with alternative financing and that households earning less than $50,000 annually were most likely to use different forms of financing.[1]
- Rent-to-own has roots in the longstanding practice known as "contracts for deed," an alternative home financing model that preyed on Black and other nonwhite people in the 1950s and 1960s who were redlined out of traditional loan opportunities.
- While the current models of rent-to-own provide more support to buyers than historical contracts for deed, the agreements are complex and the model has pitfalls that may create harm and reinforce inequity in the housing market.
- **Recommendations:** In order to ensure rent-to-own models achieve their stated goal of increasing access to homeownership and to avoid any potential predatory harms, we need to:
  - Ensure that rent-to-own companies are implementing ethical corporate practices that support buyers, such as connecting them to third-party counseling; implementing good faith contract terms; and committing to public transparency of conversion rates, contract terms, and monthly payment increases.
  - Enact state and federal regulations that protect buyers from bad actors, such as requiring that sellers record contracts with county registrars; that state agencies compile contracts and make aggregate data publicly available; that sellers transfer home titles when the buyer executes their option; and more.
- **Conclusion:** We need a stronger set of corporate practices and stricter regulatory oversight to make alternative financing a meaningful pathway to homeownership.

Introduction

The outlook for American homebuyers is getting bleak. Severe underbuilding in key job centers, steep competition from investors for available homes, rising interest rates, and a mortgage environment that disadvantages low- and middle-income households have all continued to concentrate wealth into fewer and fewer hands. With such constrained options, many have looked to alternative pathways to homeownership.

Companies that offer buyers the chance to select their homes now but defer official ownership until they've made consistent payments are increasing in popularity. Many of these arrangements are outlined in a private contract and facilitated by a newly emergent class of "Rent to Own" (RTO) companies.

RTO companies often have a stated mission of increasing homeownership opportunities. Indeed, when executed fairly and transparently, RTO products can play an important role in easing the path to homeownership for families that have low credit scores, incomes, or savings. However, RTO products still involve complex, private agreements that fall outside the traditionally regulated mortgaging systems. As a result, buyers may be at risk of entering into confusing agreements that come with terms that may disadvantage them in the long run and few—if any—protections.

While there has been some research into alternative home financing options, much of the scholarship has focused on potential harms of a similar, but different, product: Contracts for Deed (CFDs). Specifically, past research has shown that these contracts typically favor the financers, leaving little protection or benefits for the buyers.[2] Because of the private nature of such agreements, however, attempts to understand the degree to which the promises of such arrangements ever materialize (i.e. transfer of home title, building of positive credit, increasing homeownership for low-income Black and other households, etc.) have been limited.

This paper brings together the historical and ongoing effects of alternative financing starting with historically predatory CFDs and moves into the more modern RTO industry, the latter of which appears to restructure a CFD-like product for better outcomes. We analyze the offerings of six RTO companies, combining heretofore unpublished details of how the agreements work with a literature review on funding streams as well as the origins and impact of CFDs. We include insights from expert interviews into how newly emergent alternative financing companies operate.

Our analysis indicates that important aspects of RTO products vary widely, as does the likelihood of customers successfully transitioning from renting to owning. Despite avoiding the most predatory aspects of CFDs, RTO products remain complex and require more transparency. Regulators must adopt a comprehensive approach to all forms of alternative home purchase financing to meaningfully expand homeownership.

Contract for Deed Profits from the Segregated Housing Market

Modern rent-to-own products have their roots in the longstanding, mostly predatory practice of Contracts for Deed (CFDs). CFDs go by many names: land contracts, land installment contracts, and installment purchase contracts. Regardless, the principle is the same; CFDs allow a buyer to secure a home without being approved for a traditional mortgage.

Instead, the buyer puts down a down payment and agrees to certain terms and a period of monthly installments (sometimes lasting as long as thirty years), with the understanding that official ownership will remain with the seller until after the terms of the contract have been met.

From the seller's perspective, foregoing the upfront payment and security of a traditional mortgage is worthwhile because they can move quickly—they can transfer maintenance and tax responsibilities to the buyer immediately while maintaining the equity in the home and foregoing inspections or escrow-related delays. For buyers whose credit scores, debt-to-income ratios, and other characteristics might preclude them from the primary mortgage market, CFDs can feel like the only available option for housing security and eventually, hopefully, homeownership.

The terms and legal protections, however, are structured in favor of the seller and strap buyers with what some have called "all the responsibilities of homeownership and all the disadvantages of renting—with the benefits of neither."[3] Unlike in traditional mortgages, because the ownership of the home in a CFD typically remains with the seller until the final payment is made, buyers do not build any equity in the home even as they are making timely payments over years or decades.

Despite not officially owning the home, upon signing the contracts buyers become responsible for all the costs of homeownership: property taxes, insurance, and any necessary maintenance or repairs. In addition, sellers may inflate the purchase price of the home.

In one instance, a CFD seller was found to charge 65% over market value, a markup sellers justify by the risk of selling to higher-risk buyers.[4] After the inflated sale prices and ownership costs are taken into account, CFD buyers end up spending more for their homes than they would have if they received traditional financing, if they ever end up owning the home outright at all.

What also sets CFDs apart from traditional mortgage financing is that these contracts intentionally take place entirely outside of traditional mortgaging and financing systems—and the regulatory frameworks that keep them in check.

Contract for Deed Emerges in the 1950s and 1960s Chicago

Housing discrimination was still legal when alternative home financing first took off. During the Great Depression, the federal government created new programs and policies to spur homeownership and help steady an economy in free fall.

The newly created Home Owners' Loan Corporation (HOLC) and Federal Housing Agency (FHA) were tasked with making the mortgage process (which previously had required as much as 50% for down payments) more accessible to certain home buyers. In response to the increasing number of loans backed by the government, they created maps indicating the risk of lending in different areas designed to limit loans in Black and other nonwhite neighborhoods.[5] [6]

This practice of redlining—designating Black and other nonwhite neighborhoods as "high risk"—effectively closed off access to credit in these communities. Lacking the secure mortgages that white households enjoyed, those deprived of access to the primary market began to look to an emerging option: alternative home financing. Most notably, CFDs took off in Chicago's Black neighborhoods in the 1950s and 1960s.

People living in divested neighborhoods found it easier to enter into private CFD agreements, which were unencumbered by redlining limitations. CFDs promised a pathway into homeownership without the involvement of a bank or other financial institutions. In essence, the purchase is financed by the seller, rather than bank or mortgage lender.[7]

According to lawyers helping CFD buyers at the time, as many as 85% of Black Chicagoans who purchased homes between 1950 and 1970 did so on contract.[8]

Our research did not find reliable data on how many CFD buyers eventually went on to own their homes, reflecting the spotty recordkeeping in the unregulated market. By one estimate, contract sellers extracted between $3.2 and $4 billion (in April 2019 dollars) from Black Chicagoans in the 1950s and 1960s alone.[9]

The axiom that homeownership is a key to building wealth becomes a more complex and less obvious outcome when lease-to-purchase arrangements enter the mix. Do buyers eventually obtain the home? What amount of wealth and opportunity cost is involved when they do? Though marketed as a homeownership pathway, it's unclear how many contract buyers ever end up owning their homes or growing their wealth.

In fact, many of the practices were extractive: in addition to setting sales prices far above market value, some contracts required buyers to fix habitability issues within a set time—even though the lack of requirement for professional building inspections meant problems didn't have to be disclosed to buyers until after they had signed. If the buyers failed to make the upgrades, sellers could evict them.

Buyers also lacked any recourse against liens or foreclosure, and sellers weren't required to disclose any property liens before selling. Buyers attempting to fight any of these issues found that legal protections heavily favored the sellers, whose ownership of the property meant they retained the right to evict for any breach of contract. In such instances, the seller could flip the property to the next buyer, retaining the equity built by the evicted buyer and repeating the process with a new buyer.

Many contracts were structured so that the final payment was a "balloon payment"—a large payment meant to pay off the balance all at once—which forced many buyers to take out a mortgage to meet the terms of the contract, the very product they had been denied access to in the first place.

Alternative Financing Reemerges After the Great Recession

Today, as traditional homebuying has become increasingly out of reach for many households, the practices employed by CFDs have reemerged. Specifically, researchers have found a rise in CFD lending in the wake of the Great Recession, and RTOs have also become more prevalent in recent years as an alternative to traditional home financing.

In 2015, the Detroit News reported that the city saw more contracts for deed than home mortgages.[10] Whether CFD or RTO, researchers estimate that 36 million buyers have purchased homes with alternative financing and that households earning less than $50,000 annually were most likely to use different forms of financing.[11]

Though CFD and RTO are similar private home purchase agreements, RTO contracts often distinguish themselves from CFD practices by explicitly supporting the buyer towards the outcome of securing a mortgage to purchase the home in a short timeframe, often one to five years. RTO operators also take more responsibility for the quality of the home while they own it.

Comparing CFDs and RTOs

Contract-for-deeds (CFD) usually share key characteristics:

- 5-30 year terms, with costs and other terms that make eventual title conversion unlikely
- Seller retaining ownership of the house until last payment
- Residents responsible for maintenance, property taxes, insurance, etc.
- Additional predatory practices, such as inflated purchase price, lack of disclosure on house condition, immediate eviction for late payments, lack of disclosure on whether the seller is under foreclosure, etc.

Rent-to-own (RTO) models usually share key characteristics:

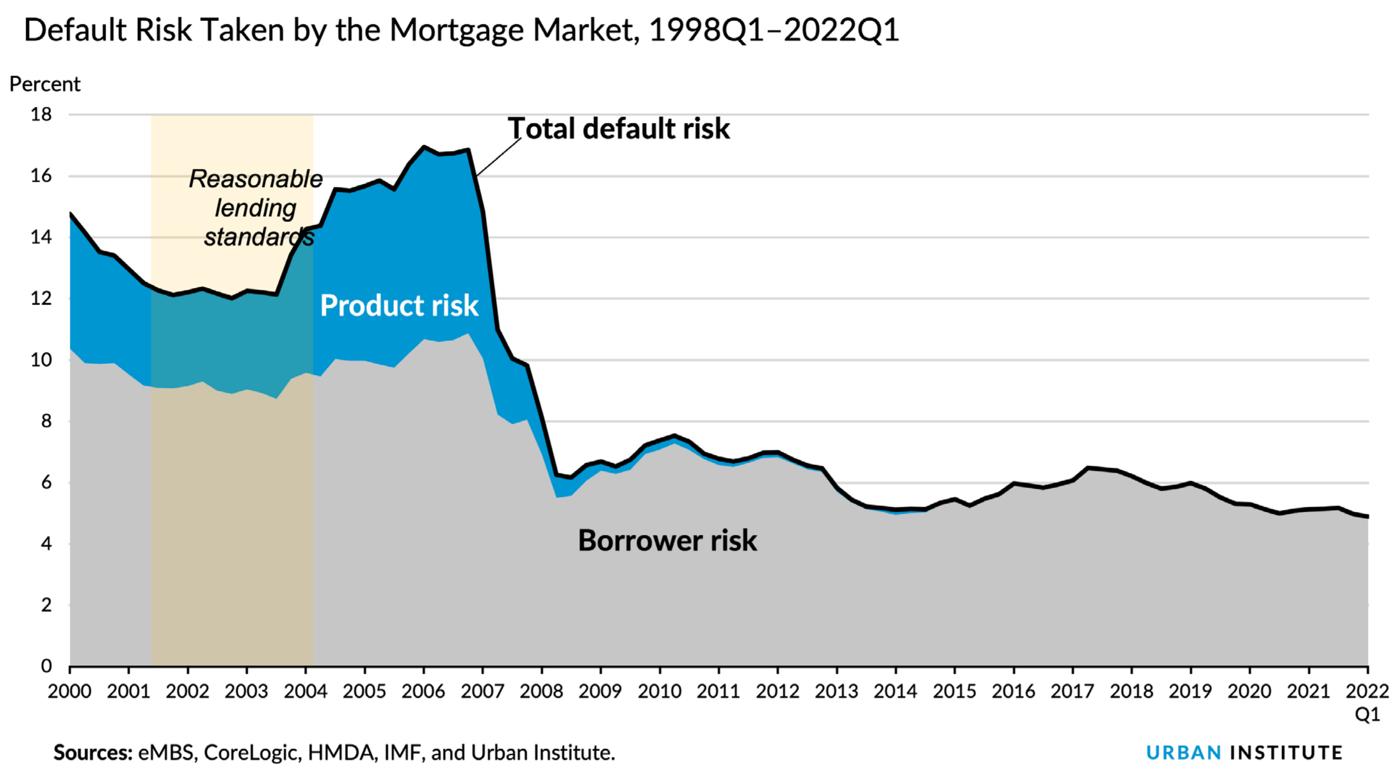
- 1-5 year terms
- Seller retains ownership of the house until the end of term, at which point the resident has an “option” to purchase the house, continue renting, or move. Sometimes the resident has to pay a “relisting fee” if they choose not to buy the house.
- Varied approaches as to whether the seller or resident is responsible for maintenance, taxes, insurance, etc.

The need for homebuyers to seek out these alternative methods is driven by many factors. Household income, wealth, and credit scores dipped during the foreclosure crisis and continue to flag in the face of repeated recessions. In recent years, the cost of constructing new homes has continued to rise,[12] and a nationwide housing shortage has pushed home prices further and further out of reach.[13] [14]

Another factor driving interest in alternative financing methods is increased investor activity in the homeownership space. Coming out of the recession, government programs designed to keep people in their homes largely failed to directly assist homeowners, and particularly failed in Black neighborhoods with high foreclosure rates.[15] In that vacuum, private equity firms purchased as many as 300,000 homes nationally and was particularly acute in neighborhoods with more than 50% Black residents.[16] [17]

Social policies enacted to combat job and income losses during the pandemic improved overall household financial health; however, private-equity-backed actors have developed faster ways to acquire moderately-priced homes.[18] [19] With investors treating the nation's housing stock as a speculative asset class, and with the chronic underbuilding of new homes (especially starter homes), home prices are out of reach for many households.

At the same time, regulatory reforms designed to insulate the financial system against the types of risky decision-making that led to the Great Recession actually limited opportunities for new home seekers. For example, credit availability in both private and agency-backed lending (Fannie Mae, Freddie Mac, etc.) tracked by the Urban Institute's Housing Finance Policy Center has found that lending standards have failed to return to reasonable risk levels in the post-recessionary period.[20]



Source: Housing Credit Availability Index by the Urban Institute

In the years leading up to the Great Recession, the level of absorbable risk in the mortgage market was too high; in the years since, new lending standards have overcorrected for the problem such that borrowers who are likely to make timely mortgage payments are not receiving loans. The Urban Institute suggests that "significant space remains to safely expand the credit box. If the current default risk was doubled across all channels, risk would still be well within the pre-crisis standard of 12.5 percent from 2001 to 2003 for the whole mortgage market."[21]

Market forces and regulatory changes since the crisis have made it even harder for low- and middle-income households, particularly people of color, to become owners. These factors, combined with volatile home prices and competition, leave many looking for homeownership pathways that don't require traditional collateral or high credit standards.

The Rise of RTO Companies

The expansion of the pool of people left out of the traditional mortgage market, along with a constriction of housing supply and increased competition from investor buyers, created a market for startups offering alternative financing. Modern-day RTO companies offer a path to homeownership through an updated version of the CFD model.

If implemented with the appropriate safeguards, this new model has the potential to help those who cannot or do not want to work within the primary mortgage market to overcome income and collateral constraints.

But the model presents significant risks. RTO agreements are complex. For the model to have a positive impact on homeownership rates, buyers must understand the highly technical fine print, as well as the tradeoff between short-term costs and long-term risks. The complexity as well as the predatory lineage of the tool requires a closer look at how such companies are operating and whether the real-world outcomes match up to their claims of expanding homeownership.

The structure and pricing of RTOs can vary widely. Some RTOs have been designed to explicitly serve low-income buyers and have partnered with public entities to keep costs low. For example, some nonprofits use RTOs on a small scale as an essential part of their work to expand homeownership.[22]

One company, Trio, has partnered with the Federal Housing Administration (FHA) to provide an RTO option to hundreds of homeowners who may not have otherwise qualified for a mortgage,[23] resulting in an average threefold increase in wealth for their primarily Black and Latinx customers, according to the company.[24]

In 2017, The Terner Center for Housing Innovation at UC Berkeley outlined the potential benefits of a formal lease-purchase option backed by traditional mortgage markets.[25]

Many other RTO companies are backed by private equity and venture capital, and the higher return expectations of those investors likely influence the pricing and structure of these agreements. In 2021, RTO leader Home Partners of America was purchased for $6B by Blackstone, a large private equity firm with significant single-family rental holdings.

Divvy, Pathway, and Landis all received significant venture capital investments between 2020-2022 from firms such as Goldman Sachs, Sequoia Capital, and Fifth Wall.[26] [27] [28] [29] However, even among these companies, pricing varies widely and can be hard for consumers to understand.

Model Comparison

In order to better understand the products and practices of these emerging RTO companies, we completed interviews with staff and executives at several of the companies, including Home Partners of America, Divvy, Pathway Homes, and Verbhouse.

When we could not get a hold of a company, we completed a detailed review of all the public information available about their products including websites, sales calculators, FAQs, and brochures provided to potential customers.

We've compared the products offered by these larger operators along several key factors that define rent-to-own arrangements. These include upfront and monthly pricing, annual rent increases, how they handle maintenance, the target length of the arrangement, how they negotiate the sale price of the home to prospective homeowners, and what (if any) fees are charged if the buyer moves out.

Where available, we've also included information on the share of buyers who convert to homeownership and the type of investment capital that is backing the arrangement (Table 1).

Monthly Payments

Some firms set monthly payments that are equivalent to what a mortgage would cost on the same house, while others set it equivalent to an algorithmic calculation of fair market rent. Additionally, some firms require a contribution to a down payment between $100-300 a month. During the purchase process, the companies assess each buyer's ability to pay and set the maximum price of the home the buyer can purchase with the company.

Many companies, including Home Partners for America and Trio, set monthly payments to fit within standard limits of an appropriate debt-to-income ratio, such as 40%. Other firms, like Divvy, allow the full payment including the mandatory savings to go up to 50%.

Data on what happens when borrowers miss a payment is spotty, and several companies declined to state their policy when asked. This includes a lack of transparency of what happens when a borrower can make their base payment but not the forced savings components. Often nonprofit operators, or those partnered with the government like Trio, build flexibility into their model to support customers when payments are difficult to make.

Option Price

When the buyer enters the contract, they often lock in a price for which they can purchase the house in the future. This is referred to as an "option." Most of the firms set the future sale price at a fixed annual appreciation rate from the initial purchase price (3-5% increase a year). The models that tap into different capital sources, such as Trio and Verbhouse, are able to offer customers an annual appreciation rate of 0-1% a year, which means that the customers are able to pay a lower price for the house if they exercise the option and immediately capture more equity.

In markets with more appreciation, either pricing structure can work in favor of prospective homeowners—who may ultimately purchase a house below market value when they are ready. For example, between July '21 to July '22 national prices rose by 15.8%,[30] meaning a buyer with an option price that even grew by 5.5% would be able to purchase at a significant discount.

However, with rising interest rates and a cooling housing market, it is possible the next few months and years could bring about a flattening of home value appreciation which may put buyers at risk of overpaying. Most firms state that their option price is "non-negotiable" even if the house has decreased in value, and no firm we spoke with was willing to go on the record to discuss how they would handle option prices if housing prices were to decline at a large scale.

If prices were to be non-negotiable in such an instance, this could box the buyer out of exercising their option by making it impossible for them to get a mortgage unless they have access to a larger down payment. This is especially worrisome if the buyer has to pay a large fee to leave the house without purchasing, a common practice that is detailed in the section on "voluntary exits."

Equity Growth & Forced Savings

One significant potential benefit of the rent-to-own model is offering the buyer a set period of time to prepare for homeownership, getting some of the benefits of homeownership during that time. For example, one financial benefit of owning a home with a traditional mortgage is the forced savings: a required monthly contribution that builds a buyer's ownership in the home and therefore their wealth. Another benefit is to build equity if the house's value appreciates above the sale price. Several of the rent-to-own models we evaluated provided some of these benefits to the buyers, designed to help them eventually transition to owning the property.

For forced savings, two companies we evaluated required buyers to make a monthly contribution to a home savings account, above the normal monthly payment. For example, Divvy's mandatory "home savings investment" is calculated to equal 0.10-0.25% of the home's value, or $200-500 a month on a $200,000 house. This is equivalent to 3.6-9% of the home's value over a 3-year period, which could cover the down payment and some of the closing costs depending on the mortgage option for which the buyer can qualify.

Two other companies, Trio and Pathway (via their Pathway Savings product) provided a different path. If the buyer purchases the home, then the companies give a contribution to the purchase price equivalent to 3-5% (Trio) and 2.5% (Pathway) of the home's value. This offers a powerful benefit to the buyer if they choose to move forward with the purchase.

None of the companies we evaluated with operating products provided a way to access any growth in the home's equity without using the option to purchase the home. However, if the buyer does purchase the home and the contractual option price is less than the home's market value, as mentioned above, they immediately gain some equity. On the flip side, if the home has decreased in value and the buyer walks away from the house without purchasing, they are protected from losing equity. One company, Verbhouse, which is not yet operating, does plan to provide a pathway for buyers to access the home's equity growth even if they do not purchase the home.

Maintenance

CFDs required buyers to be responsible for all maintenance and upgrades, without receiving any equivalent increase in their share of the home's value. This burden is relatively small for minor repairs, such as a broken window, but can be financially difficult if a major repair is needed. In contrast, most of the RTO companies we researched handled most if not all maintenance during the lease term. Home Partners of America is especially clear, detailing all types of maintenance that they cover through a third-party vendor. Trio provides customers with warranties and insurance that cover most repair issues. Most other companies summarize their policies by stating buyers are only responsible for "cosmetic" repairs. Landis stands out as the only firm that requires buyers to share 50/50 in all maintenance costs above $200.

Another area that is crucial to explore is how the contracts handle improvements to the house that the buyer makes, such as renovation projects or upgrades. If the buyer makes these upgrades, but then ultimately isn't able to purchase the house, most of the companies do not have policies in place to credit the buyer for their investment in the home.

Maintenance (cont.)

Recent news coverage has investigated some of the companies' follow-through on maintenance requests, exposing that companies do not follow-through on the promises that they will handle major maintenance.[31] Deep investigation of this issue was not in-scope of this report, but is a worthy area for further research.

Homeownership Counseling

All of the RTO models we evaluated offered some form of homeownership counseling for buyers to help them prepare to take ownership of the home. Trio, the organization that partners with FHA, stands out as providing government-certified counseling for 24 months pre-purchase and 18 months post-purchase.

However, most do not require counseling, and the counseling programs offered often do not have to be certified as they are in the traditional mortgage industry. Some feature short training videos or apps, while others have formal partnerships with homeownership counseling agencies. Several firms have considered incentivizing participation in these programs, but at the point of publishing, none of these policies had been finalized.

Voluntary Exits

One of the greatest potential benefits of rent-to-own models, in addition to a gentle path to homeownership, is the potential optionality. If a buyer does not like the home, financial circumstances change, or if they need to move, all of the RTOs we examined allow buyers to walk away. Moreover, most of the RTOs do not charge people if they leave the arrangement. All the models that included equity savings and growth in their model allowed the residents to take this money when they left.

However, two models, Landis and Divvy, charge a substantial fee (3% and 2% of the home price, respectively) to people who do not purchase the house. This is marketed as a relisting fee to help these firms cover their costs. For a lower-wealth buyer hoping to transition to homeownership, this fee can be a significant financial setback. As noted above, these losses may be in addition to investments the buyer made in maintenance or renovations.

Disclosure of Terms and Conditions

Most of the products we evaluated provided transparency on costs, including fees and how the option price would change over time. For example, Home Partners for America provides a very detailed list of fees and how they differ by state, including utility costs and fees for pets.

Other companies included details on fees in their FAQ sections. All the companies we evaluated offered complete transparency on how the option price would change over time, and on fees that would be charged at move-out if the buyer did not buy the house.

Success Rate Transparency

All the companies we looked at advertised the path to homeownership as a core part of their value proposition to customers. Some, like Divvy, present it as almost certain: "In 3 years or less, you're ready to buy."[32] Others, like Home Partners for America, focus on the optionality: "We give you the exclusive right to buy it and you decide if it's right for you."[33]

But do customers actually buy the homes? At this time, none of the firms advertise the rates of success among their buyers—as in how many want-to-be buyers actually end up buying the home outright. When asked directly, two companies—Home Partners for America and Divvy—provided their current success rates and the others declined. The range of available rates, 38-50% (see Table 2), demonstrates that a large share of want-to-be-buyers is not converting to homeownership.

However, more transparency is needed to understand whether this is representative of the industry at large.

When asked, most of the companies claim that when people do not convert to homeownership, it is often because they want to move elsewhere or because their credit score remains too low. This is important information for future buyers to know when evaluating whether the RTO model is right for them.

Pathway Homes set the minimum credit score for their program at 600 for this reason—the highest minimum score of the products. While it decreases access to their program, the Pathway team believes this helps ensure that buyers they serve are more likely to convert to homeowners by the end of the program.

Table 1: Summary of Rent-to-Own Models

Organization	Term	Min. credit score	Initial upfront payment	How monthly payment is set	Annual monthly payment increase	Built-in buyer down payment savings / contributions	How "option" price is set	Maintenance	Move out fee	Success/ conversion rate	Backing capital
Home Partners of America	1 year, renew up to 3-5 years	580-620 depending on market	Standard security deposit	Estimate of market rent	3.75%	None	3.0-5.5% increase/year on original price	All habitability repairs handled by Home Partners, cosmetic handled by buyer	None	38%	Private Equity
Trio	2-3 years	Minimum of 580, could go down to 550	Origination fee (similar to mortgage fee)	Fixed equivalent to FHA mortgage	1%, with a new product with 0%	Contribute 3-5% of down payment costs if the buyer purchases the home after 24 months.	Set based on price at move-in, plus closing costs.	N/A	None	78%	FHA mortgages
Divvy	3 years	Minimum of 550	2% of purchase price	Estimate of market rent, plus savings investment	0%	Buyers contribute a mandatory home savings investment each month equivalent to .10-.25% the home value	Between 3.5-5.5% increase/ year	All habitability repairs and handled by Divvy, cosmetic repairs and appliance repairs handled by the buyer	2% of house price	Around 50%	Venture Capital and Private Equity
Landis	1-2 years	Minimum of 550	2% of purchase price	Estimate of market rent, plus savings investment	N/A	Buyers contribute a mandatory home savings investment each month	3% increase/ year	Buyer pays all maintenance under $200. Above $200 is shared 50/50 between Landis and the buyer	3% of house price	N/A	Venture Capital and Private Equity
Pathway HomeSavings	1 year, renew up to 5 years	Minimum of 600	2.5% of purchase price	Estimate of market rent	Varies, but around 3.75%	2.5% deposit is doubled to 5% if buyer purchases after 5 years	3-6% increase/ year	Pathway is responsible for "major" maintenance	None	N/A	Venture Capital and Private Equity
Verbhouse*	5 years	None	5% of purchase price	On-par with monthly mort-gage costs at 10-20% down	0%	20-25% of monthly payments go to downpayment savings	0% increase/ year	Verbhouse covers all repairs	None	N/A (product not yet operating)	Pension investment

*Note: Verbhouse is not yet offering a public RTO product.

Model Comparison Summary

Together, modern RTO models offer some significant improvements on traditional CFDs with clear terms, future option prices, and connection to homeownership counseling. However, very important factors, such as how maintenance is handled and how an option price may change in a shifting market, leave room for buyers to be forced to spend significant cash to keep the arrangement in place.

Furthermore, with no standards on disclosures, contracting, and data on conversion rates, it is hard to further dig into these models to ensure they are fairly advertised.

The source of capital for each company plays a role in setting the required profitability of each model and highlights clear benefits for models that are designed to access government-backed financing sources.

Ultimately, even the least expensive RTO products remain complex. It is hard for any buyer to weigh the trade-off between locking into a future option price with the benefits of potentially getting into a home sooner in an escalating market. These complexities make it critical for buyers to receive clear information and for regulators to increase their role in protecting buyers against bad actors.

Regulation and Company Practices Can Ensure Alternative Financing Lives Up to its Claims

This paper covers the risks for home buyers who use alternative financing, but there are risks for companies as well. Recent media coverage links RTO companies to similarly-structured credit offerings that let consumers purchase items now and pay in installments, known as buy-now-pay-later (BNPL).[34]

Regulators including the Consumer Financial Protection Bureau have moved to monitor such credit offerings for potential predatory intent.[35] In 2020, rent-to-own company Progressive agreed to pay out $175M after the Federal Trade Commission sued the company for deceptive marketing.[36] To avoid risk, company claims must match up with reality.

While we wait to see if federal regulators will take action, each state is responsible for creating and enforcing alternative financing rules. Often, state regulation focuses on CFDs in ways that don't apply to RTO models. This is a missed opportunity, but an example of where regulation that takes a more comprehensive approach to alternative financing could go.

Some have moved to extend certain traditional mortgage consumer protections to CFD buyers; while mortgages from the primary mortgage market are not risk-free either, they are regulated in ways that alternative financing is not, affording a basic degree of consumer protection.

Still, the patchwork of protections leaves many to fall through the cracks. As states fill in the gaps, there are voluntary changes that RTO and CFD providers can make today to improve outcomes for their buyers.

Additionally, further understanding of how the industry should be regulated is hampered by a significant lack of data. Almost all of these forms of seller financing are not recorded—official property titles just show that the houses are owned by the sellers.

Pushing alternative financing activity into the open will help the industry, regulators, and customers have the information they need to engage with these financing products most effectively.

A stronger set of corporate practices and stricter regulatory framework can allow alternative financing to support dreams of homeownership. It is important that this approach is comprehensive, covering the dynamics of the emerging RTO industry while also plugging important holes in the regulatory oversight of CFDs and similar products that were discussed in the first section of this paper.

Company Practices

- Educate company staff on historical lineage of alternative financing
- Connect buyers with third-party homebuyer counseling opportunities
- Commit to public transparency on homebuyer conversion rates, typical contract terms, and monthly payment increases
- Implement good faith contract terms:
  - The timing of the home title transfer is transparent, with opportunities to share equity between buyer and seller while the buyer makes payments
  - The state of the property, including necessary repairs and existing liens, are disclosed before signing contract
  - Maintenance responsibilities are transparent and responsibilities for habitability improvements and most other maintenance remain with the seller
  - Limit re-listing or other fees tied to the buyer exiting the arrangement before purchasing

Regulation

- Require that sellers record contracts with county registrars
- Require that state agencies compile contracts & make aggregate data publicly available
- Require that companies advertising alternative financing publicly disclose the borrower conversion rate
- Require that sellers transfer home title when the buyer executes their option
- Require that sellers disclose liens and known maintenance issues before contract signing
- Require that sellers provide remedy processes before forfeiture & eviction
- Require the conversion of existing contracts to meet updated standards

Many states have already implemented certain elements of the above list. The strength of protections depends on how *comprehensive* a state's regulation is—many just do a few of these—and in the *enforcement* of such provisions. States and localities must fund registrar offices and others to enforce alternative financing rules and can offset enforcement costs with financial penalties for non-compliant sellers, after a right-to-cure period, if terms are not met.

Table 2: A Sample of Contract for Deed Regulations by State[37] [38]

	California	Minnesota	Michigan	Ohio	Oklahoma	Florida	Texas	Illinois
Recording of Sale Requirements		✓		✓	✓		✓	✓
Limits/Remedy for Forfeiture or Foreclosure			✓	✓				✓
Repairs/Maintenace Protections/ Clarity in Contract		✓						✓
Disclosure of Liens or Necessary Repairs				✓				✓
Property Tax Protections/Clarity in Contract	✓	✓			✓			✓
Mandatory Appraisals and/or Inspections								
Enforcement through Civil Penalties	✓	✓						
Extension of Traditional Mortgaging Protections					✓	✓		

* This list is a summary and not intended to be exhaustive

Sources: National Consumer Law Center, Summary of State Land Contract Statutes; Joint Center for Housing Studies, The American Dream or Just an Illusion?

Ultimately, the harmful outcomes of alternative financing persist because of the patchwork of protections as well as the patchwork of regulation type, with most legislation focusing on either CFD *or* RTO, in lieu of a comprehensive alternative financing regulation. Minnesota, Wisconsin, North Carolina, and New Jersey have banned rent-to-own, for example, whereas Oklahoma and Florida have automatically applied traditional mortgaging protections to contract buyers.[39]

As with traditional mortgage regulations, we need a federal framework such that vulnerable buyers don't slip through the cracks because of where they live. Given the likelihood for continued innovation, especially when homeownership is hard to reach, attempts to mitigate the harms and loopholes outlined in this paper should focus broadly on all forms of housing purchase that use seller financing with the aim of covering rent-to-own, contract for deed, and whatever iteration comes next. Such efforts would minimize the likelihood that regulating one form of alternative financing would lead to an increase in another, less-regulated form.

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