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Try before you buy

By Mark Ellwood
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Christian Egan, a 34-year-old banker originally from Brazil, has long coveted a new apartment in New York. But the resilience of the city property market, even in the current downturn, has prevented him from buying. “I’ve been very close in the past three or four years but I’ve been waiting for the sell-off that hasn’t happened yet – or at least, not in the magnitude I expected,” he says.

This year, however, his girlfriend, Julia Rutkowski, discovered a solution – a rent-to-own scheme recently launched at 75 Wall, a downtown luxury condominium development. “She did a sweep of the area and got into every single building there,” Egan says. They both liked the condo and “renting with the option to buy was a kicker – not something I was originally looking for but something nice to have”.

He moved into his three-bedroom flat a month ago (as a divorced dad, he needs space for his children when they visit) and now has nine months to decide whether to convert his accumulated monthly rent into a downpayment. He thinks of it as an opportunity to try a new building and neighbourhood before buying, as well as a canny financial hedge. “It’s my first time living in the Financial District and that’s a completely new experience,” he says. “It’s [also] protection. If the market has a V-shaped recovery and prices [are] higher in 12 months, I’m capped; I have a certain [purchase] price listed on the contract and ... haven’t completely thrown away all the money from renting.” At the same time, if Manhattan property values fall and he realises he wants to live somewhere else he can end his lease and start house-hunting again.

The programme Egan happened upon at 75 Wall signals a new, pragmatic attitude among high-end developers. Where once rent-to-own was seen as a low- and middle-market sales booster, in straitened economic times it has become an option for everyone. Egan’s 349-unit building has many other attractions. It was designed by architect David Rockwell and incorporates a Hyatt hotel; there is a fitness centre, games room, and rooftop terrace with barbecue pits, hammocks and hot tubs for residents; and the apartments, priced from $630,000 or $2,675 per month for a studio, have 10ft ceilings, oak flooring and ample storage. But the opportunity to put a full year’s rent towards a future purchase is an extra selling point. All tenants are automatically enrolled in the programme. Those who want to buy do; those who don't must move at the end of their 14-month lease.

RENT-TO-BUY

How it works

Joe Trader, a hypothetical tenant at 75 Wall, agrees to pay $5,395 per month to rent a two-bedroom condo that is listed for sale at $1.35m and, thanks to a "two-months-free" incentive offered by the developer, his effective payments are just $4,624. (Some developments charge a slight premium for rent-to-own but this is the market rate.) After nine months, Joe must decide whether he wants to buy the condo at the end of his 12-month lease. If he does, the developer credits 100 per cent of his money – $55,488, or 12 months of $4,624 payments – back to him to put towards the purchase of the property at closing.

The modern origins of rent-to-own – that is, buying in instalments or hire purchase – can be traced back to the postwar boom in household amenities. Companies such as Rent-a-Center in the US sprung up to help working class consumers afford expensive items, such as a televisions or kitchen appliances, letting them lease the product for a time and then either return it or apply the payments they'd made towards a purchase.

The concept soon spread into real estate. "Rent-to-own transactions have been around since the 1960s in various formats and they've always been aimed at the affordable housing market, lower-income-bracket folks with substandard credit scores," says John Kobs, founder of website Irenttoown.com. The 1980s downturn brought a boom in the sector as developers, facing a glut of unsold properties, started to recruit credit-worthy renters whose only obstacle to buying was not having the cash for a downpayment.

Traditionally, such rent-to-own schemes didn't make sense in the luxury sector. Rental rates tended to be lower than mortgage costs on equivalent properties and, in any case, potential buyers typically had more than enough money available to cover the up-front costs of a purchase.

But in the current economic downturn, real estate professionals are rewriting the rules. "Financing restrictions today are so onerous that the developers are looking to create some cash flow," says Richard Grossman, executive director of sales at Halstead Property in New York. "Frankly, from the owner's point of view, you get some income and then some sales built in two years from now, when the market will surely be in a better condition than today."

Kobs, who has seen page views on his website rise from 135,000 in the first half of 2008 to 1.6m in the same period this year, agrees. "Developers need to use everything possible in their arsenal now to expand the potential-buyer bucket and rent-to-own is very low-hanging fruit."

The industry doesn't have official figures for these sorts of transactions but the anecdotal evidence is clear. In New York alone several other luxury buildings now have rent-to-own programmes. They include 99 John Street, a 27-storey art deco building downtown that has been converted into condos starting at $550,000 or $2,345 per month; L Haus in rapidly gentrifying Long Island City, where the 122 apartments cost up to $1.5m or more than $6,200 per month; the 65-residence Solaria development in Riverdale in the Bronx, with units priced from $660,000 to $4.35m and rents determined case-by-case; and Northside Piers in Williamsburg, Brooklyn, which has East River views, rooftop cabanas, valet parking and 15 of 180 units that cost $620,000-$1.8m set aside for a pilot lease-to-own scheme at $3,100-$4,500 per month.

There are examples across the US – especially in hard-hit states such as Florida, Nevada and California – and, increasingly, around the world. In Spain, real estate website Spainhouses.net lists more than 700 rent-to-own options, including a five-bedroom villa with swimming pool in Málaga priced at €1.4m or €4,000 per month, 100 per cent of which can be put towards a purchase, as well as a three-bedroom duplex near the beach in Barcelona, listed at €2.2m or €12,000 a month. In heavily oversupplied Dubai, Emaar Properties is offering lease-to-own options at several master-planned communities, including the planned 63-storey, luxury hotel-linked Downtown Burj Dubai linked with a luxury hotel, with renters able to put their first year of payments towards a purchase. And, in the Phillipines' Quezon City, New Manila, Cathedral Heights Urban Development is offering a similar scheme on one- to three-bedroom executive townhouses with communal swimming pool and landscaped gardens priced from 6m-12m pesos (£75,000-£150,000).

Philip Gesue, who oversees real estate projects for Orient-Express Hotels, a Bermuda-based company with properties in 25 countries, says he's planning to bring rent-to-own to the resort market too, with a project in Porto Cupecoy, St Maarten, where residences will cost up to $3m. "With what's happened in the stock market, it's not a bad idea," he explains. "Even people who are more affluent have lost portions of their portfolios and are being more cash conscious. They may want a unit and know they can afford it but not want to have to close on a large downpayment in spring or summer 2009."

Some overstretched developers simply choose to convert sales projects to rentals but, according to Gesue, that "screams of desperation". By contrast, "rent-to-own has big pluses for both parties. The renter gets the benefit of test driving and saving money towards a downpayment. And the developer gets one of two things: either a person who goes into contract who wouldn't otherwise or a gigantic amount of rent for the unit" since the schemes have historically involved above-market rates – though that's less true in today's buyers' market.

Gesue recalls using the tactic in a Kansas City development a few years ago; three-quarters of the units were already sold but it was an effective way to squeeze out more sales in the home stretch.

Asher Ouazanan, leasing director of the new Artech condo tower in Aventura, just north of Miami, is another proponent of luxury rent-to-own schemes. "It started here [in Miami] about two or three years ago," he says. "The idea was 'OK, sales aren't going as well as we thought [and] banks aren't approving loans but we have to find a way to fill up the building and bring in revenue to keep it operational and afloat. So let's let first-time buyers, people who don't have the money to purchase out front, test drive the building and become more comfortable.' Things are still shaky for a lot of people out there and it's difficult to ask people to jump into an agreement. So you can let things settle down a bit."

At Artech (pictured right), a 10-storey building designed by architect Carlos Ott that has a cinema, 43-slip marina and shared 60ft yacht, tenants can convert nine months of $1,500-$3,250 in rent into downpayments on units priced from $280,000 to $1.3m. The offer was a compelling one for 24-year-old gym manager Michael Davila. "I thought [an Artech flat] would be way out of my budget; [in fact] I didn't have a budget because I wasn't planning on moving anywhere," he says with a laugh. "But I'm 24 and I've got to start settling down, start making some investments, not wasting my money in renting. Using that money for something is very intriguing."

Grossman sees Davila as a classic candidtate for luxury rent-to-own. While the target demographic is now wealthier than previously, "it's still aimed at a younger sector, which has had less opportunity to develop some assets," he says. As a result, "it's more common for studios and one-bedrooms rather than the bigger apartments".

He and other professionals note that anyone entering into a lease-purchase agreement should make sure the company offering it is solvent enough to honour the commitment at the end of the term. They must also confirm they're not obliged to purchase should they decide against it or find a better deal and, where possible, they should drive a hard up-front bargain. Egan, for one, regrets not pushing for his end-of-lease offering price to be lower than the listing. "I think it's overvalued," he says.

Overall, though, participants in the schemes think they've found a market-beating strategy. "I hadn't heard of anything like [it] before I looked at Artech but now I hear it all the time," Davila says. "It's a very good trend."

Egan agrees. "Everyone I know thought the idea was really interesting, especially the people who work in the markets on Wall Street."

Additional reporting by Jillian Reid and Elka Requinta