

**Testimony of Sarah B. Mancini
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on behalf of its low-income clients**

On

**Hijacking the Dream: How Land Contracts and Lease-Options Hinder Rather than
Advance Access to Homeownership**

**Before the United States Senate Banking Committee,
Subcommittee on Housing, Transportation, and Community Development**

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¹ Since 1969, the nonprofit **National Consumer Law Center® (NCLC®)** has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people in the United States. NCLC's expertise includes policy analysis and advocacy; litigation; expert witness services, and training and advice for advocates. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending, and Home Foreclosures. NCLC attorneys provide assistance on a daily basis to the attorneys and housing counselors working with distressed homeowners across the country. This testimony is based on the field experience of these advocates as well as our knowledge and expertise in mortgage origination and servicing. Additionally, NCLC has, through analysis, reports, litigation, and policy advocacy, been leading the national effort to address the problems created for low-income consumers who have entered into land contracts.

I. Introduction and Summary of Testimony

Chairwoman Smith, Ranking Member Lummis, and Members of the Committee, thank you for the opportunity to testify on behalf of the low-income clients of the National Consumer Law Center (NCLC) regarding alternative home purchase methods. I am Co-Director of Advocacy for NCLC.²

The two alternative home purchase methods I address today are land installment contracts, also known as land contracts or contracts for deed, and leases with option to buy. Both types of transactions are generally marketed to low-income and credit-challenged consumers as a means of obtaining access to homeownership when other avenues appear inaccessible. My colleagues and I have filed cases in several states challenging the legality of the arrangements that you are reviewing today. Additionally, we have consulted with attorneys in legal services programs in dozens of states around the country who have represented other low-income victims of these arrangements.

Our extensive work studying these transactions³ has led us to conclude that these alternative transactions do not provide a meaningful pathway to homeownership. Rather, land contracts and leases with option to buy are both costly and destructive detours that diminish the likelihood that consumers entering into these contracts will ever own a home.

While some non-profit community-oriented providers of land contracts appear to facilitate real homeownership opportunities,⁴ these are the exception rather than the rule. Our experiences indicate that the vast majority of these transactions *fail*. We estimate that **more than half of land contracts fail**.⁵ Indeed, as explained in section II.E, we believe that these transactions are *designed to fail*.

² In my work at NCLC, in addition to litigation, my principal duties include serving as a resource to private and legal aid attorneys, as well as to federal and state regulators and enforcement agencies, on complex housing finance issues. Before joining NCLC, I worked for Atlanta Legal Aid, where I represented low-income homeowners facing the risk of foreclosure and homebuyers in predatory home purchase contracts for over 12 years.

³ See e.g. Jeremiah Battle et al., Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color, National Consumer Law Center (2016), available at <https://www.nclc.org/images/pdf/pr-reports/report-land-contracts.pdf>.

⁴ Karen Ann Kling et al, “In Good Faith: Reimagining the Use of Land Contracts,” University of Michigan Poverty Solutions, available at <https://poverty.umich.edu/files/2021/05/PovertySolutions-Land-Contracts-PolicyBrief.pdf> (June 10, 2021).

⁵ As explained in Section II.C, we view this estimate as conservative—in other words, the likely failure rate is actually much higher than 50%. Our estimate is derived from a combination of NCLC’s extensive work on land contracts, an informal survey of a dozen experienced attorneys in diverse states across the nation, and the completed analyses referenced.

Despite these astronomical failure rates, according to the U.S. Census, 3.5 million people were buying a home through a land contract in 2009, the last year for which such data is available.⁶ This number likely grossly understates the prevalence of land contracts, as many contract buyers do not understand the nature of their transaction sufficiently to report it.⁷ More recent evidence suggests that land contracts experienced a resurgence in the wake of the foreclosure crisis. One analysis found that land contract sales in the Twin Cities had increased 50% from 2007 to 2013.⁸ Reports from *The New York Times* and *Bloomberg* revealed significant interest from private equity-backed investors in using land contracts to turn a profit on the glut of homes foreclosed during the 2008-2015 foreclosure crisis in blighted cities around the country.⁹

The Pew Charitable Trusts conducted a nationwide survey of consumers who reported having ever borrowed money to purchase a home, and estimated that out of the roughly 180 million home borrowers in the United States, 6% of home borrowers (nearly 11 million people) had used a land contract, and roughly the same percentage had entered into a lease-option, at some point in time.¹⁰ These transactions disproportionately impact people and communities of color. Pew's research found that Hispanic and Non-Hispanic Black households were more likely to have alternative home financing compared to other households.¹¹

Zachary Anderson was in his early 50's and was working as a mechanic for the City of East Point when he saw signs dotting his southwest Atlanta neighborhood advertising homes for sale with low downpayments and low monthly payments.¹² He called the number on one of those

⁶ Heather Perlberg, "Apollo's Push Into a Business that Others Call Predatory," *Bloomberg*, April 7, 2016, available at <http://www.bloomberg.com/news/articles/2016-04-07/apollo-s-push-into-a-lending-business-that-others-call-predatory>.

⁷ Peter M. Ward, Heather K. Way, and Lucille Wood, *The Contract for Deed Prevalence Project: A Final Report to the Texas Department of Housing and Community Affairs* (Aug. 2012), available at <http://www.tdhca.state.tx.us/housing-center/docs/CFD-Prevalence-Project.pdf>.

⁸ Jeffrey Meitrodt, "Contract for deed can be house of horror for buyers," *Star Tribune* (July 5, 2013), available at <http://www.startribune.com/jan-14-contract-for-deed-can-be-house-of-horror-for-buyers/185756982/>.

⁹ Alexandra Stevenson, Matthew Goldstein, "Market for Fixer-Uppers Traps Low-Income Buyers," *The New York Times*, Feb. 21, 2016, A1.; Heather Perlberg, "Apollo's Push Into a Business that Others Call Predatory," *Bloomberg*, April 7, 2016, available at <http://www.bloomberg.com/news/articles/2016-04-07/apollo-s-push-into-a-lending-business-that-others-call-predatory>.

¹⁰ Pew Charitable Trusts, "Millions of Americans Have Used Risky Financing Arrangements to Buy Homes" (Apr. 14, 2022), <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/04/millions-of-americans-have-used-risky-financing-arrangements-to-buy-homes>.

¹¹ *Id.*

¹² All of the facts in this paragraph come from the Third Amended Complaint in DeMarkus Horne et al v. Harbour Portfolio, Civil Action No. 1:17-CV-954, U.S. District Court for the Northern District of Georgia.

signs and ended up entering into a contract with Harbour Portfolio. He was told to sign the papers and Fed-Ex them back to the company. He received a letter that said, “Congratulations on the purchase of your new home!” Mr. Anderson, like many buyers in a land contract, had no idea that the transaction he entered into was any different than a traditional mortgage loan. His contract carried a 10% interest rate, and the price of the home was roughly five times what the company had paid when they acquired it from Fannie Mae after a foreclosure sale. Mr. Anderson made substantial repairs to the home. He repaired the roof, replaced burst pipes, removed hazardous trees, repaved the driveway, painted, and installed gutters. He paid faithfully on the contract for years; paid property taxes, paid homeowner’s insurance – only to discover at a certain point, when looking at the property tax records, that the deed to the house was not in his name. Mr. Anderson was at risk of losing all of his investment in the home.

As discussed below, significant steps are needed to protect other would-be homeowners like Mr. Anderson from the harms of transactions that impose all of the burdens of homeownership with none of the protections. We recommend that Congress take the following actions in order to begin to limit the substantial harms caused by these alternative products:

- Work to broaden access to traditional mortgage loans, especially “small dollar” mortgages of less than \$125,000;
- Spur research on the prevalence and outcomes of land contract and lease-option contracts around the country;
- Encourage the Consumer Financial Protection Bureau to clarify the applicability of federal consumer protections to land contract transactions and to pursue enforcement action against bad actors.

II. Alternative Homeownership Transactions Strip Consumers of Their Money and Their Dreams

A. Land Contracts Rest on a False Promise of Homeownership.

Land contracts are a form of seller-financing in which the homebuyer promises to pay a fixed amount of money, at a certain interest rate, over a certain term (often 20 or 30 years). However, unlike conventional financing of homes, the deed to the home remains in the seller’s name until the buyer has paid the entire purchase price. If the buyer misses a single payment at any point during the term, typically the contract purports to allow the seller to cancel the contract and claim the borrower has forfeited the benefits of the contract. The seller then asserts that it is entitled to keep all the buyer’s payments under the contract, the value of all improvements made by the buyer, and any equity the buyer had built up over the term.

Consumers, lured by the promise of home ownership, spend hard-earned dollars and sweat-equity refurbishing uninhabitable homes. Often properties sold on land contracts are in horrendous condition: they may be missing all necessary systems (including electric, plumbing, and heating), have major foundation issues or active lead hazards, or have pending vacate orders from the city government because they are considered uninhabitable. Lack of clear ownership prevents buyers from accessing grants and loans for home improvement, making repairs more difficult.

In many states, buyers who fall behind can be swiftly evicted, erasing all of their investment, or part-way through the land contract term, the homes can be claimed by an unknown lienholder with a higher priority mortgage or tax lien. In addition to the lack of legal clarity, buyers often are not aware of title issues, prior liens, or code violations, because these transactions usually do not involve a traditional closing by a title attorney. The fact that contracts are typically not recorded in the deed records means that buyers' interests are not protected even from liens or conveyances signed after the land contract. Unrestricted forfeitures allow land contracts to operate in a legal no-man's land, in which contract buyers have none of the protections of a homeowner and also none of the protections of a tenant (such as the landlord's obligation to provide habitable conditions).

Land contract transactions have certain core features that put consumers at significant risk. First, the transactions are typically invisible in the public deed records, which means that contract buyers risk having their interest jeopardized by a later transfer or encumbrance. The failure to record these transactions undermines the reliability of the public land records and the ability to convey good title of the properties. Second, the forfeiture remedy in land contracts creates a means of depriving contract buyers of all of their investment in the home, and any equitable interest in the home, without legal process and without a public auction of the home for highest and best value. The forfeiture remedy reflects the central unfairness of these transactions, in which contract buyers are told that they have all of the obligations of homeownership (including paying the property taxes, repairing and maintaining the property), but none of the legal rights or protections of homeownership.

While some state legislatures have attempted to address the core structural unfairness of the forfeiture remedy, other states have merely built up a framework for enforcing land contracts (including the harsh forfeiture remedy upon default) in ways that keep the land ownership records clear. Still others have chosen to require up-front disclosures or ongoing statements, providing information, but no substantive protection, to contract buyers. Even when the state legislature's intent is to provide safeguards for the buyers, the consequences of a disclosure-only

system actually undermine the protections that might otherwise exist through judicially-created protections.¹³

NCLC has evaluated all of the state statutes governing land contracts,¹⁴ and—unfortunately—despite the best of intentions by state legislators, most do not provide sufficient protections to make these toxic transactions safe for most consumers.

B. Lease-Options Are Two Contracts: A Standard Lease and an (Often Worthless) Option

Although the state statutes on land contracts may not sufficiently protect consumers from losses, some do provide enough rights to consumers to incentivize sellers to formulate their contracts differently just to avoid those restrictions. Those state statutes, imposing some limited protections for land contract buyers, are likely the reason for the increase in the problematic lease-option transactions that pervade the marketplace today. Sellers hoping to avoid even those minimal state level protections applied to land contracts have begun labeling transactions as leases with option to buy, even when in substance they are still land contracts.¹⁵

¹³ In a number of states, courts have treated land installment contracts as equitable mortgages. The result of emphasizing the substance over form of these transactions in this way can be that the rights normally provided to the borrower in a standard mortgage transaction are accorded to the buyer in a land contract. *See, e.g.*, *Shimko v. Marks*, 632 N.E.2d 990 (Ohio Ct. App. 1993) (doctrine of partial performance and documentation in the form of receipts established existence of installment land sales contract despite parties' failure to comply with statute of frauds); *Thornton v. Marcum*, 2008 WL 836368 (Tenn. Ct. App. Mar. 31, 2008) (applying doctrine of equitable estoppel to order specific performance of oral installment land sale contract after buyer had made regular payments for three years); *Yarto v. Gilliland*, 287 S.W.3d 83 (Tex. App. 2009) (enjoining eviction where defendant raised plausible title claim based on oral contract for deed that fell within exception to statute of frauds). *Cf.* *Sykes v. Pool*, 2015 WL 1189460, at *3 (Ky. Ct. App. Mar. 13, 2015) (reversing summary judgment for sellers and remanding for consideration of extrinsic evidence; “[C]ontract was silent on the interest rate and was ambiguous as to the manner in which insurance and taxes would be added to the principal and escrowed by the Appellees. . . . [I]t is odd that the Appellees accepted payments without question for many years, and then suddenly demanded that such payments be made in addition to the monthly payment amount. . . . Accordingly, we hold that the contract was ambiguous and that the Appellants were entitled to present extrinsic evidence to the Court for resolution of this dispute.”); *Grexa v. Hollenbaugh*, 2014 WL 5421222 (Ohio Ct. App. Oct. 27, 2014) (despite the mandatory language of section 5313.02, a land contract may be held to be enforceable even though it does not strictly comply with the statutory requirements; but finding that no land installment contract existed here because the contract showed only an intent to enter into a formal land installment contract in the future); National Consumer Law Center, *Home Foreclosures Chapter 13* (2d ed. 2023), *updated at* www.nclc.org/library.

¹⁴ National Consumer Law Center, *Summary of State Land Contract Statutes* (Apr. 30, 2021), available at <https://www.pewtrusts.org/-/media/assets/2022/02/summary-of-state-land-contract-statutes.pdf>.

¹⁵ *Id.* at 11.

A lease-option transaction involves two contracts: a residential lease and an option to buy the property for a certain price within a certain time period, usually between 6 and 24 months. Until the option is exercised, the consumer is a tenant. At the time the contracts are entered into, the consumer makes a substantial payment for the option, usually ranging from \$2,000-\$5,000 and sometimes significantly more. These very expensive option fees are the primary reason that lease-option transactions are unfair, as the option fee is non-refundable and the borrowers are typically unable to exercise the option.

Too often consumers in a lease with option to buy take on unreasonable burdens because they believe that they will soon own the home in question. This may include making required repairs during the lease term, which in almost all states, violates landlord-tenant laws. Generally, the large option fee is forfeited if the option is not exercised. Often the option part of the transaction is worthless because the option price for the home is well above the fair market value, making it nearly impossible for the consumer to obtain independent financing, even if their credit and income would otherwise suffice.¹⁶ These transactions require the consumer to obtain separate financing for the home purchase which was not available to the consumer at the inception of the transaction, and is likely to be similarly unavailable when the option to purchase must be exercised. Consumers in lease-option transactions rarely have the benefit of an independent appraisal or a home inspection prior to entering into the option contract. Therefore, inflated purchase prices are common. Lease-option sellers often mislead vulnerable buyers into believing that renting the home for a period of time will improve their credit rating sufficiently so they will qualify for separate financing and be able to exercise the option. In reality, this almost never happens.¹⁷ If the consumer misses a rental payment at any time, the option to buy is usually forfeited, and the money paid for the option to buy is lost.

Finally, it is important to note that some leases with option to buy are really land contracts in disguise. This happens when investors call the contract a “lease with option to buy” but set up the contract so that at the end of the “lease” term, the consumer will have paid the full purchase price and should be entitled to receive a deed. A true lease-option should involve a good faith expectation by both parties that there will be a separate transaction if and when the option is exercised. Nonetheless, contracts that operate in a legal grey area are common.

¹⁶ National Consumer Law Center, Short Survey of Legal Services Attorneys, July 2023.

¹⁷ Rachel Cruze, “Rent-to-own Homes: How Do They Work and Is It a Good Idea?”, Ramsey Solutions (Feb. 2, 2023), <https://www.ramseysolutions.com/real-estate/how-does-rent-to-own-work>.

C. The Vast Majority of Alternative Transactions Do *NOT* Result in Home Ownership

Data is sparse regarding the success or failure rates of land contract transactions and non-existent for leases with options. As explained here, we estimate that the failure rates are well above 50%, compared to a roughly 1% foreclosure rate for FHA mortgage borrowers. While our estimate is based on our extensive experience along with data from all currently available sources, it is not a statistically verified figure. The Atlanta Federal Reserve Bank is currently working on a comprehensive study of this issue that is expected to generate results in the coming year. There are several sources of data that shed light on the failure rates of land contract home sales.

Texas. In 2012, researchers at the University of Texas published a study of land contract prevalence and outcomes in the Colonias border region of Texas.¹⁸ The authors of this report looked at land contracts recorded between 1989 and 2010 in ten counties. Examining a representative sample of transactions more closely, they found that 45% of recorded contracts for deed had been canceled, 37% were still in an active contract, and roughly 18% of the contract buyers had obtained a deed.¹⁹ If the 37% of active contracts ended up with similar outcomes to the contracts that had terminated as of the date of the study (roughly 30% successful and 70% unsuccessful), this would mean **an overall 71% failure rate**.

Pennsylvania. Another source of data is lawsuits that have been filed against large-scale for-profit sellers of rent-to-own homes, like the suit filed by the Attorney General of Pennsylvania against Vision Property Management.²⁰ Pennsylvania was one of a handful of states where Vision was most active during the 2010-2016 time period. The Attorney General of Pennsylvania filed lawsuits against Vision and related companies for unfair, deceptive, and illegal conduct. In the complaint, the AG included data about contract outcomes based on pre-suit discovery.

The data regarding Vision transactions in Pennsylvania showed that **almost no one entering into these contracts had succeeded in becoming a homeowner**. In the complaint filed in 2019, the Attorney General of Pennsylvania alleged that based on files it had obtained, out of approximately 450 homebuyers who had entered into Vision's lease-option agreement in Pennsylvania between 2013 and 2016, **only 2% had successfully obtained a deed to the home**,

¹⁸ P.M. Ward, H.K. Way, and L. Wood, "The Contract for Deed Prevalence Project" (University of Texas at Austin, 2012), <https://www.tdhca.state.tx.us/housing-center/docs/CFD-Prevalence-Project.pdf>.

¹⁹ *Id.* at VII.

²⁰ Commonwealth of Pennsylvania v. Vision Property Management, LLC et al, Civil Action No. GD-2019-014368, Court of Common Pleas of Allegheny County, PA (Complaint, filed Oct. 10, 2019) at pp. 17-26.

and only 25% of the agreements were still in effect as of March 2019.²¹ The remaining 73% of agreements had been terminated, including both evictions and voluntary move-outs. **Even if all of the contracts that were active at the time the data was collected were successful, a 73% failure rate is staggering.** Imputing the outcomes of the terminated contracts onto the active contracts would result in a projected overall failure rate of 98%.

Of 170 homebuyers who had entered into a lease-option with Vision from 2016 to the present in Pennsylvania using a slightly different form contract, only 0.5% had been successful in obtaining ownership of the home, and only 40% of the leases were still in effect as of March 2019.²² **Roughly 60% of the contracts had already failed, only three years into a seven-year option period.**²³

Analysis of Lease-Option Data from Two Companies. An analysis of lease-option transactions involving two companies, Home Partners of America and Trio, presents a murky picture of the overall success rates of lease-option contracts in multiple states.²⁴ **The report shows that cohorts of buyers from Home Partners had failure rates of between 62-84%.**²⁵ For Trio, the authors concluded there was a failure rate of roughly 22-27%, based on the fact that out of 183 transactions originated between 2016-2018, 75 households purchased the home “and 21 exited without purchasing.”²⁶ This begs the question of how to count the roughly 87 out of 183 households that supposedly had neither purchased the home nor exited the contract, three to five years after entering into a three-year option contract. **If those 87 households should be deemed unsuccessful because they are no longer in an active option contract, then the failure rate for Trio transactions over that time period would be roughly 60%.** The report acknowledges that two of the three authors are paid consultants for Home Partners and Trio. A detailed independent analysis of Home Partners’ outcomes based on publicly available data concluded that in its three largest markets (Atlanta, Chicago, and Tampa) Home Partners had filed for evictions on more properties than it had sold.²⁷ In Chicago, the company had sold less

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ Michael Stegman et al, Lease-to-Purchase: How to Build Homeownership, Moody’s Analytics (July 2022), available at <https://www.moodyanalytics.com/-/media/article/2022/lease-to-purchase-how-build-homeownership.pdf>.

²⁵ *Id.* at 10.

²⁶ *Id.* at 12.

²⁷ Rebecca Burns, “Private Equity Sold Them a Dream of Homeownership. They Got Evicted Instead,” Insider (July 7, 2023), <https://www.insider.com/home-partners-rent-to-own-low-success-rate-2023-5>.

than one-third of the 195 properties it acquired up through 2016, although the five-year option window had expired for all of those original tenants.²⁸

Legal Services Attorneys in Various States. Additionally, NCLC has data from our own work and that of our legal services colleagues around the nation.²⁹ When we surveyed over a dozen attorneys³⁰ who have been working in this area for many years, from a variety of states, they estimated that the failure rate for private land contract transactions to be at least 50%.³¹ For land contract transactions involving corporate entities and multiple sellers, they estimated that at least 70% of these transactions fail.³²

Whether the actual failure rate of land contracts and lease-options is 80%, 70% or even as low as 50%, the failure rates are too high. The average foreclosure rate for mortgages in the U.S. is less than half a percent, with the highest annual foreclosure rate in the past twenty years in 2010 at 2.23%.³³ The foreclosure rate for FHA-insured mortgages, the primary mortgage product used by first-time homebuyers, hovers around 1%.³⁴

D. When Contracts Fail, the Negative Impact on Consumers is Massive

When land contracts and lease-options fail, consumers are generally far worse off. Not only are their hopes of homeownership dashed, but they have often lost significant sums spent on the transaction and the home. The downpayments for the land contract and the option fees for the lease-option transactions are much larger than security deposits generally required in standard leases. They are also typically non-refundable, unlike a security deposit, and many courts will

²⁸ *Id.*

²⁹ *See, e.g.*, Legal Assistance of Western New York, Beware of Rent-to-Own Agreements, <https://www.lawny.org/node/64/beware-rent-own-agreements>

³⁰ The legal services attorneys surveyed have represented land contract purchasers in the following states: Florida, Georgia, Illinois, Indiana, Iowa, Maryland, Minnesota, Pennsylvania, South Carolina, Texas, Vermont, and Virginia. They have an average of 15 years of experience representing consumers in this type of transaction, and one-third of them have over 20 years of experience.

³¹ Respondents were asked to consider private transactions, and not land contracts involving mission-driven nonprofits.

³² Multiple seller was defined in the survey as a land contract seller that has entered into at least five transactions.

³³ Ruchi Gupta, US Foreclosure Rate by Year, State, and City, Finmasters, (May 25, 2023) <https://finmasters.com/foreclosure-rate/#gref>.

³⁴ *See, e.g.*, Dep't of Housing and Urban Development, FHA Single Family Loan Performance Trends (April 2023), https://www.hud.gov/sites/dfiles/Housing/images/FHALPT_Apr2023.pdf; Dep't of Housing and Urban Development, FHA Single Family Loan Performance Trends: Credit Risk Report (May 2019), https://www.hud.gov/sites/dfiles/Housing/documents/FHALPT_May2019.pdf.

enforce that contract term. As many of the homes involved in these transactions are uninhabitable at the inception of the contract, the consumers have often spent thousands of dollars making repairs necessary for their families to live in the home, and provided hundreds of hours of sweat equity. Many consumers pay the back property taxes that are due on these properties. All of these investments—both financial and emotional—are losses when the transactions fail.

Additionally, consumers—who are often promised a way to build their credit histories—may end up with black marks on their credit report that make obtaining a mortgage, and even finding another decent place to rent, impossible. Lease-option contracts often contain exorbitant late fees, default fees, and even eviction fees, such that by the time a consumer vacates the property, they are saddled with a judgment for an amount higher than they could have imagined.³⁵ A judgment or collection account on a credit report often makes it impossible to qualify for a mortgage loan under mainstream underwriting and credit score rules.³⁶ If these companies report late payments to credit reporting agencies, as part of their purported credit-building process, they will create black marks on the consumer’s credit report that leave that consumer unable to find even a landlord that will rent to them, let alone a real opportunity to purchase their home.³⁷

E. Misaligned Incentives: Sellers Benefit from Contract Failure

Credit that benefits both borrowers and lenders is healthy—affording borrowers the opportunity to obtain goods and services to which they would not otherwise have access and providing lenders a steady and honorable business opportunity. Yet in some credit markets, the interests of lenders and the borrowers diverge. Predatory lending happens when lenders benefit from, or are callous about, the borrower’s inability to afford the loan.

The incentives in predatory lending programs are not parallel: the lenders’ interests are at cross-purposes from those of the borrowers. Recent history has provided several examples of dysfunctional markets where incentives have been misaligned, causing serious pain for consumers:

³⁵ First Amended Answer and Counterclaims, *Notals Management v. Vermelle Jackson*, Civil Action No. 19D90418, Superior Court of DeKalb County, Georgia (Oct. 4, 2019) (describing lease-option contract with various unfair fees and terms); Answer and Counterclaims, *Trio v. Shakkas*, Case No. 21ED184341, Superior Court of Fulton County, Georgia (citing staggering default fees).

³⁶ Cardozo Law, “Will Having a Collector After Me Lower My Credit Score?” <https://www.cardozalawcorp.com/faqs/having-a-debt-in-collections-will-affect-your-credit-score.cfm>.

³⁷ Chi Chi Wu, Even the Catch-22’s Come with Catch-22’s: Potential Harms and Drawbacks of Rent Reporting, National Consumer Law Center (Oct. 24, 2022), <https://www.nclc.org/resources/even-the-catch-22s-come-with-catch-22s-potential-harms-drawbacks-of-rent-reporting/>.

- Before the 2009 reforms, credit card companies pushed consumers into a “sweat box,” making substantial profits from late and over-the-limit fees and hair-trigger interest rate increases.³⁸
- The business model of payday lenders is based on repeat lending to borrowers who cannot afford to repay balloon payment loans and are forced to roll them over again and again. The Consumer Financial Protection Bureau has found that one in five payday loan sequences ends in default.³⁹
- The foreclosure crisis revealed that profits based on originating and securitizing mortgages rather than the repayment of those mortgages over time led to a push to increase loan volume at the expense of solid underwriting and affordable loans, because originators were incentivized by up-front fees.⁴⁰

Land contracts and lease-option transactions end in failure so often because they are built to fail. The sellers actually benefit more when the consumer defaults and can be evicted, losing all of the money they invested in the home. When the consumer is forced to leave their home and forfeit their investment, everything lost by the consumer goes right into the pocket of the seller. Often the buyer has made substantial repairs, leaving the home in better condition (to the seller’s ultimate benefit) than when they entered it. An added bonus for the seller after the consumer’s failure is that it now has the opportunity to turn around and repeat the process with another disadvantaged consumer who dreams of homeownership -- obtaining a new large downpayment or option fee. Every time a consumer fails the seller has another opportunity for profit, without even the need to find another property in which to invest.

II. The Players Have Vastly Different Power in the Marketplace

In both land contract and lease-option transactions, the dynamics are similar: unsophisticated buyers invest substantial money to purchase, and often to refurbish, uninhabitable homes, without any protections for their investments. These consumers almost always poor and are disproportionately from communities of color. They long to own their own

³⁸ See, e.g., Hearing of the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, House of Representatives, *Consumer Debt: Are Credit Cards Bankrupting Americans?* (Apr. 2, 2009), <https://www.govinfo.gov/content/pkg/CHRG-111hhrg48440/html/CHRG-111hhrg48440.htm>

³⁹ CFPB, Press Release, “Consumer Financial Protection Bureau Proposes Rule to End Payday Debt Traps” (June 2, 2016), <http://www.consumerfinance.gov/about-us/newsroom>

⁴⁰ See e.g. *Crisis and Response: An FDIC History, 2008-2013*, Chapter 1 at 7, available at <https://www.fdic.gov/bank/historical/crisis/chap1.pdf> (2023).

homes but have been unable (or believe they are unable) to qualify for a traditional mortgage loan.

A. Alternative Transactions Are Targeted at Disadvantaged Consumers

Land installment contracts have long been associated with predatory and abusive real estate practices in low-income neighborhoods – but not all communities have been impacted equally.⁴¹ Communities and people of color have borne the brunt of these predatory transactions, both historically and in recent decades. In tightly segregated urban neighborhoods, often populated by Southern migrants, land contracts have long been the primary way to purchase a home. It was estimated that 85% of the properties purchased by African-Americans in Chicago in the 1950s were sold on contract.⁴² Then, as now, homeownership through these deals was often a mirage, and buyers lost their homes, their down payments, their sweat equity, and the money they paid for repairs, maintenance, insurance, and interest. The land contracts enriched the speculators but stripped wealth from low-income and African-American communities. They led to “debt peonage or impoverishment for many black contract buyers, and an almost guaranteed decay of the communities in which such sales were concentrated.”⁴³

The legacy of credit discrimination and reduced regulation of mortgages provided fertile ground for the predatory lending practices that plagued American homebuyers in the early 2000s. Americans throughout the United States were inundated with high-cost, unsustainable credit.⁴⁴ This toxic financing resulted in the 2008 foreclosure crisis that further stripped wealth from low-income communities. These communities bore the brunt of the foreclosure crisis and the economic meltdown that followed.⁴⁵ Investors purchased foreclosed properties in bulk and then began selling these properties back to residents of the community through land contracts. Data from 2016 showed that land contracts outnumbered mortgage transactions that year in Detroit.⁴⁶ As with earlier forms of predatory lending, contract sellers target low-income buyers with limited resources who may not qualify for conventional mortgages.

⁴¹ Heather Way, “Informal Homeownership in the United States and the Law,” *St. Louis University Public Law Review* Vol. 29, No. 1 (2009), 113. See also Ta-Nehisi Coates, “The Case for Reparations,” *The Atlantic*, May 21, 2014.

⁴² Beryl Satter, *Family Properties: Race, Real Estate, and the Exploitation of Black Urban America* (Metropolitan Books, 2009), 4.

⁴³ *Id.* at 6.

⁴⁴ Justin P. Steil et al, “The Social Structure of Mortgage Discrimination,” *National Institutes of Health* 33(5) *Journal of Housing Studies* 759–77 (2018).

⁴⁵ *Id.*

⁴⁶ Joel Kurth, “Land Contracts Trip Up Would-be Homeowners,” *The Detroit News*, Feb. 29, 2016.

Immigrants and limited English proficient populations are especially at risk for this type of financing as they search for affordable housing without access to conventional financing.⁴⁷ Language, identification, and credit barriers too often bar immigrants from accessing the mainstream lending industry.⁴⁸ In NCLC’s interviews with legal services attorneys around the country, almost universally the advocates reported that the land contract buyers were largely or exclusively families of color: African-American or Latino homebuyers.⁴⁹ Some described marketing schemes that appeared to target African-American and Spanish-speaking consumers for these toxic transactions.⁵⁰ One attorney reported that certain land contract sellers exploit homebuyers’ vulnerable immigration status: instead of evicting them through a court of law, which would allow them to raise defenses, the seller would threaten to report them to immigration officials if they don’t move out of the home.⁵¹

Consumers in land contract transactions are even more vulnerable if their contract is for the purchase of a manufactured home and they are simultaneously renting, not purchasing, the land underneath. These transactions are particularly harmful when the landlord fails to maintain the infrastructure for the residents leasing the land.⁵² Many manufactured homes cannot be moved without falling apart – giving landlords an extreme amount of power over these homebuyers. Because of these heightened risks, laws that promote resident ownership of manufactured home communities, including rights of first refusal when a community is being sold, provide key protections and are gaining ground in a number of states.⁵³

⁴⁷ M. Wright, “Installment housing contracts: presumptively unconscionable,” *Berkeley Journal of African-American Law and Policy*, 18.1, 97-129 (2016).

⁴⁸ National Consumer Law Center, “Coalition Comments to the Task Force on New Americans on Expanding Language Access within the Financial Sector” (Feb. 7, 2023), <https://www.nclc.org/resources/coalition-comments-to-the-task-force-on-new-americans-on-expanding-language-access-within-the-financial-services-sector/>.

⁴⁹ Battle et al, *supra* note 3; phone interview with Marilyn Mullane and Joe McGuire attorneys with Michigan Legal Services, and Ted Phillips, United Community Housing Coalition (Mar. 29, 2016); Phone interview with Nicole Shannon, attorney with Legal Services of South Central Michigan (Mar. 30, 2016); Phone interview with Jennifer Schultz, attorney with Community Legal Services of Philadelphia (Mar. 29, 2016); Phone interview with David Loetz (Apr. 6, 2016), senior attorney with Iowa Legal Aid; Phone interview with Daniel Lindsey, managing attorney with Legal Aid Chicago (Apr. 5, 2016).

⁵⁰ *E.g.*, phone interview with Luke Grundman and James E. Wilkinson, attorneys with Mid-Minnesota Legal Aid (Mar. 31, 2016).

⁵¹ Phone interview with Marilyn Mullane and Joe McGuire, Michigan Legal Services, and Ted Phillips, United Community Housing Coalition (Mar. 29, 2016).

⁵² I’m Home and National Consumer Law Center, *Manufactured Housing Resource Guide: Promoting Resident Ownership of Communities* (2023), https://www.nclc.org/wp-content/uploads/2022/08/cfed-purchase_guide.pdf.

⁵³ *Id.*; see also ROC USA, *What is a ROC? How is It Different?*, https://www.nclc.org/wp-content/uploads/2022/08/cfed-purchase_guide.pdf.

B. Many Sellers Have Private Equity Backing

In the past, the primary sellers of land installment contracts were individuals with a few properties. While this dynamic still exists, the use of land installment contracts is no longer limited to “mom and pop” operators. More recently, large investment firms with private equity backing, some of which profited from the high-cost subprime lending that fueled the foreclosure crisis, are increasingly using land installment contracts to make a profit from the significant supply of foreclosed homes.⁵⁴

Harbour Portfolio Advisors was one of the largest players in this shadowy corner of the real estate investment market. As reported by the *New York Times*, the Dallas-based firm has bought more than 6,700 homes to sell through land contracts, mostly in Ohio, Michigan, Illinois, Florida, Georgia, and Pennsylvania.⁵⁵ Harbour, which raised more than \$60 million from investors, purchased more properties from Fannie Mae’s bulk sale program from 2010 to 2014 than any other single buyer.⁵⁶ Harbour used South Carolina-based National Asset Advisors (NAA), formed by the principals of RECA Limited Partnership, to service its land contracts.⁵⁷

Another major player that pursued land contracts as an investment is private equity firm Apollo Global Management. Through a real estate investment trust, Apollo partnered with Baton Rouge-based Home Servicing to sell homes on land contract.⁵⁸ Home Servicing acquired more than 400 houses, mostly in Southeastern cities.⁵⁹ Apollo’s real estate investment trust had at one point invested more than \$40 million in single family homes.⁶⁰

In the wake of the 2008-2015 foreclosure crisis, investors like these purchased thousands of foreclosed properties through bulk sales and property tax foreclosures and operated a large

⁵⁴ Alexandra Stevenson, Matthew Goldstein, “Wall Street Veterans Bet on Low-Income Buyers,” *The New York Times*, April 18, 2016, B1; Alexandra Stevenson, Matthew Goldstein, “Market for Fixer-Uppers Traps Low-Income Buyers,” *The New York Times*, Feb. 21, 2016, A1.

⁵⁵ Alexandra Stevenson, Matthew Goldstein, “Market for Fixer-Uppers Traps Low-Income Buyers,” *The New York Times*, Feb. 21, 2016, A1.

⁵⁶ Alexandra Stevenson, Matthew Goldstein, “Market for Fixer-Uppers Traps Low-Income Buyers,” *The New York Times*, Feb. 21, 2016, A1.

⁵⁷ Alexandra Stevenson, Matthew Goldstein, “Wall Street Veterans Bet on Low-Income Buyers,” *The New York Times*, April 18, 2016, B1; Linked In Profile of National Asset Advisors, LLC, available at <https://www.linkedin.com/in/national-asset-advisors-a5114429>.

⁵⁸ Heather Perlberg, “Apollo’s Push Into a Business that Others Call Predatory,” *Bloomberg*, April 7, 2016, available at <http://www.bloomberg.com/news/articles/2016-04-07/apollo-s-push-into-a-lending-business-that-others-call-predatory>.

⁵⁹ *Id.*

⁶⁰ *Id.*

scale business of “selling” the homes through land contract and lease-option transactions. In more recent years, other nationwide players have entered the marketplace hawking a lease-option transaction for consumers who are not currently able to buy a home, but who are looking at a higher price point than earlier entrants like Harbour Portfolio and Vision Property Management. These include players like Home Partners of America, Trio, and Divvy Homes. While their websites appear more polished and they allow the would-be homeowner to select the home that they wish to “rent to own,” the business models of these companies present many of the same problems as any other lease with option to buy. Specifically, many of them require a substantial up front option fee (which may be partially or fully non-refundable, depending on the circumstances, if the tenant is not able to exercise the option); many require rents that are above fair market rent; and many state in the lease that the tenant is obligated to make necessary repairs, despite landlord-tenant laws to the contrary.⁶¹

IV. Policy Recommendations

We are very encouraged that Congress has started to examine the problems caused by land contracts and lease-purchase transactions. Below we suggest several steps that Congress should take now to develop more data, improve the availability of traditional financing, and encourage enforcement of existing protections. We think that Congress will conclude that additional legislation is necessary to address the fundamental predatory nature of these transactions, and we would be happy to work with Congress in crafting appropriate legislation.

There is much that can be done to address the problems with these alternative financing transactions. We recommend that all policy actions be designed to accomplish the twin goals of 1) improving the opportunities for low-income and minority consumers to achieve homeownership, and 2) protecting all consumers from the predatory and dangerous transactions that are described in this testimony.

Enlarge opportunities for home ownership through traditional financing. One of the best ways to improve access to homeownership would be for Congress to take immediate action to encourage—if not require—federally regulated or insured financial institutions to originate small dollar mortgage loans. Opening up access to reasonably priced mortgages with fair terms would go a long way towards obviating the need for land contracts and lease with options.

⁶¹ See Rebecca Burns, “Private Equity Sold Them a Dream of Homeownership. They Got Evicted Instead,” Insider (July 7, 2023), <https://www.insider.com/home-partners-rent-to-own-low-success-rate-2023-5> (citing Home Partners’ significant eviction rates and a number of repair issues); Matt Goldstein, “Divvy Homes Says Rent-to-Own Deals Work. Next Year Will Be a Test,” The New York Times (Nov. 25, 2020), <https://www.nytimes.com/2020/11/25/business/divvy-homes-real-estate-homes.html> (citing above market rents); Ainsley Harris, “Inside the rent-to-own startup that’s putting aspiring homeowners in financial jeopardy,” Fast Company (Oct. 24, 2022).

Gather comprehensive and reliable information about the extent of the problems caused by these alternative transactions. To accomplish the second goal, an important preliminary step should be gaining a thorough understanding of the extent of the current problems. First, the U.S. Census should be tasked with asking additional questions in its decennial and annual reports that will yield timely and reliable information on the prevalence and usage patterns of both types of transactions. Second, the GAO or an appropriate federal agency should be tasked with determining the usage and failure rates of these transactions nationwide.

Encourage impactful regulatory and enforcement actions. Members of Congress should encourage the Consumer Financial Protection Bureau to issue guidances that:

1. Clearly articulate the applicability of the federal laws and regulations governing the financing of consumer dwellings to land contract transactions, including required disclosures, the prohibition against applying pre-dispute arbitration clauses, the requirement to verify ability to repay the loan, and the ability of consumers to rescind the transactions when appropriate.
2. Describe how the use of these transactions to evade state and local requirements for the rental of habitable homes violates the prohibition against unfair, deceptive, and abusive actions.

The CFPB and state Attorneys General should also step up enforcement efforts against sellers who are attempting to evade federal or state laws through predatory and unlawful practices.

V. Conclusion

Thank you for the opportunity to testify today. The risks presented to consumers from “rent-to-own” home transactions are significant. There is no evidence that these transactions present a viable pathway to homeownership. In order to help would-be homeowners make progress towards the American Dream, we must focus on options that have a proven track record of success. Land contracts and lease-options are not among them. I am happy to answer any questions.