

## ARTICLE

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One day I was sitting in my office and feeling full of myself due to having just completed my sixtieth (plus) Lease Option deal, when a phone call changed my life.

A few months earlier I had placed a young married couple in a property on a Lease Option. I had a Lease Purchase with the owner. A kind of sandwich deal, but I had a contract of sale with my seller and just an open straight Option with the tenants. That's what the Gurus tell you to do is do a Lease Purchase with the Owner and a Lease Option with the Tenant Buyer. A Lease Purchase is, of course, a contract that allows me an "equitable" claim to the property. A Lease Option is a lease with a separate unilateral option- to-purchase by the Optionee. In this arrangement, the assumption is that Tenant Optionee has no equitable interest in the property, allowing a simple eviction of a defaulting tenants; but requiring full foreclosure should I be the one in default (my equity interest would force a foreclosure process rather versus eviction).

I was about three months after my tenant lessees moved into the property the fateful call came. The wife informed me that her husband had left her for another honey, and that she (now thoroughly pregnant) had no means of support and no way of paying the rent. And neither had she resources to find other accommodations. Me, being the sweet fellow I am, gave her a month then started the eviction process, which of course prompted her to seek out an attorney in order to recover her option fee.

- I don't believe at the time that either her or her attorney had any idea that they could claim an equitable interest or ask to recover the option fee. I think the attorney quite luckily happened upon this stuff. What I have speculated all along is that, in searching for his assets and of course making a claim on everything, all the pieces just kind of fell in to place. I don't even think the attorney even really knew what a Lease with Option was and in her search came across the Arizona legislation and decided what the heck, it's worth a shot. You know how it is when a suit is first filed, everything and everyone is named.

Also, she didn't really seek out an attorney. One was assigned to her by the State of Utah when she filed for Child Support. That is why they initially started seeking out his income and assets. I guess because all this was related that the attorney also helped her with the pending divorce action.

As is always the case, the attorney thought she had died and gone to Heaven with a no-brainer case like this. The most helpful attorney, in looking out for her client's best interests, with no hope of personal reward (not), took the case on a contingency \* basis for free and promptly filed a claim of "equitable interest" in-order to delay the eviction and force a drawn-out judicial foreclosure process (i.e., to get her client free rent, and to force me to settle out of court in order to get the monkey off my back and cut my losses, which I would have done early had I known that some monkeys can turn into full grown gorillas).

Again, the attorney was assigned to her by the State initially for Child Support enforcement. As a result of the attorney's due-diligence, I guessing that is when she came across this Arizona thing and decided to give a try which led to me not being able to promptly evict and which led to the need for me to consider foreclosure rather than eviction.

Next, the attorney came up sufficient precedents to proceed with some assurance of being able to bury me in the long run. The cases had to with Lease Options wherein the tenants were stayed from eviction and, in one case, even ended up owning the property after a lengthy court battle.

\*See the Accompanying Article on "My Conversation with Judge Pearce".

To make a long story a bit shorter, suffice it to say that my tenant was able to remain in the property (rent-free) for a total of 8 months...and that this drawn-out mess finally resulted in my resorting to judicial

foreclosure versus any continuing any eviction efforts. However, I didn't have to start the foreclosure process, because my seller's lender started it for me... for a few reasons: one for non-payment of the mortgage, and the other for the due-on-sale violation (i.e., when I admitted to the tenant's being an equity holder, I was automatically admitting to a DOSC even beyond my seller's having violated it just because of the extant unapproved Option).

During the course of all of this, the tenant's attorney filed suit against me to recover the \$10,000 Non-Refundable Option Fee and all Rent Credits (3 months), and seller filed suit against me for breach of contract in allowing his property to end up in foreclosure (which case he eventually compromised on). By the time the time the army of attorney's were finished with me, I was finished in the creative financing business. Having settled out of court too late, I lost pretty much everything I owned and decided that this creative real-estate business was definitely not for me.

Now, at this point they all concluded that if they had a claim against me, then it would only make sense that they could lien all my other interest in my other Lease Options. I ended up settling out court, which forced me to sell off my interests in the remaining Leases Purchases and giving back all the deposits and rent credits, even on rent payments that were never made (from the option fee). I had to pay all attorneys fees and court costs, and even the all the seller's expenses as well.

I was forced to walk away from over a dozen active deals still in place, and make the decision to either start over gain or give up. I chose "give up." I wanted absolutely no part of the creative real estate business ever again.

HOWEVER: Almost two years later, a friend of mine in the business and familiar with my story, knew of NARS, the Equity Holing Trust Transfer and Bill Gatten. After being told about the program it was at least another year before I decided to check it out and attend a workshop. The rest is history. Let's just say that Bill showed me my niche in this business, and an unconventional but safe and easy method of real-estate investing that would protect me and my properties (and my clients) from the capricious whims of all the opportunist and deadbeats out there. Bill and NARS are, without a doubt, responsible for a ton of the way-better-than-average income, wealth and financial freedom that I now enjoy.

Following is an actual conversation with [Judge Pearce](#).

To put this into context; I have a personal relationship with [Lester Pearce](#) and he is the judge that hears the eviction actions in the North Mesa Justice Court jurisdiction where my apartments are located. I've been in front of him many times when I had to evict a delinquent tenant.

I should also mention that [Judge Pearce](#) co-authored Arizona's Landlord/Tenant laws when he was an Arizona Senator. He knows what he's talking about!

I was looking to purchase some apartments from [Judge Lester Pearce](#) and was hoping to not have to put down a lot of money. Banks usually require 20% down on apartment financing. I was hoping he'd consider a Lease-option...I was thinking win/win. I was surprised to have the following conversation with him:

**Me:** Would you consider giving me a Lease-option/Lease-purchase on your apartments?

**Judge:** Absolutely not. It would be a bad deal for me. Lease-options benefit only the buyer/tenant, not the property owner. It would put me at great risk.

**Me:** What do you mean?

**Judge:** There is a little secret about evictions that few people know.

If a tenant mentions and can show me in court during an eviction hearing that he has given the property owner more than 1.5 times the monthly rent up front and claims equitable title or any other elements that would indicate he has [equitable title](#), I will throw the case out.

It is illegal to require more than 1.5 times the monthly rent up front in Arizona ([ARS Article 2, 33-1321a](#)). I view it as a possible "down payment"

**Me:** What do you mean? Throw it out?

**Judge:** My court only deals with matters of possession of the property. I don't judge on matters of title. I'm not allowed to. The eviction hearing only determines who has the right to possess the property. If there is a chance that the tenant has an [ownership interest](#), I can't evict him.

I never raise these issues in court myself, of course. But, if a delinquent tenant shows me reasonable evidence that looks like he might have [equitable title](#), I won't evict him.

Receiving more than 1.5 times the monthly rent up front ([ARS Article 2, 33-1321a](#)) from the tenant by the landlord is only one of many elements that can indicate a disguised sale. If the landlord requires the tenant to maintain the property, that is also a violation of the Landlord/Tenant Act and could indicate [equitable title](#) has been given to the tenant. ([ARS Article 2, 33-1324a](#))

**Me:** What does that mean?

**Judge:** It means that the tenant has a [possible ownership interest](#) in the property. He might not be renting anymore. He might be an [owner](#). I cannot evict an [owner](#).

You now have to get an attorney and initiate a Judicial Foreclosure to get that person out. The tenant will be able to live in the property until a judge tells him to leave.

**Me:** How can the tenant now "own" the property.

**Judge:** Many Lease-options inadvertently meet the elements of a [disguised sale](#). *The contract might "say" it is a lease with an option to buy but if it has the ingredients of a sale, it's a sale. If it "walks like a duck and talks like a duck..."*.

If there is a question of title, I can't hear it. Therefore I will not force the tenant out of the property. He might actually have an [ownership interest](#) in it!

**Me:** How long could this take?

**Judge:** Upwards of 7-8 months maybe even a year.

**Me:** Why does it take so long and what would something like this cost?

**Judge:** Typically, when financing is put into place, a trustee holds a "Trust Deed" against the property giving the trustee the right to sell the property after a certain amount of time has passed following a default of the loan.

When you get a loan, a "note" and "trust deed" is created. The note outlines the terms of the loan and the trust deed is a lien placed against the property and is the instrument that is used to force the defaulting party out the property and to sell it.

When the trustee initiates a foreclosure in case of default, there is a statutory time period that must pass to give the defaulting party a chance to bring the contract current. After that time passes, the trustee holds a trustee sale. Because there is no court action taken, the time frame is much shorter and legal fees are much lower. The reason it goes so smoothly is that both parties agreed upfront in **legally recognized terms** on how the default would be handled.

In the case of a Judicial Foreclosure, there is no trust deed, and because there were no **legally recognized terms** spelled out in the agreement in case of default, a judge has to decide the issue.

*If the lease is not recognized by the court as a lease, it doesn't get the benefits that go along with a **legally recognized lease**. If the judge thinks a [sale has taken place](#) instead of a lease, the rules governing foreclosures would apply. For this reason, possession of the property must be decided by a judge in a position to hear matters of title and this process can be extremely expensive; *Costs could be upwards of \$10,000 or more, not including paying the back mortgage payments during the suit.**

**Me:** How often does this happen?

**Judge:** *A lot more than you might think.*

Here are five things that may violate the law or cause the court to classify the transaction as a sale.

1. Collection of more than 1.5 times the monthly rent as an Option Deposit.
2. Collection of an Option Deposit or Rent Credit to be credited to a Purchase or to discount the Purchase, as in a Down Payment.
3. Pre-Determining an end Purchase Price as in delaying or disguising a sale.
4. The Lessee also holding an Option on the same property in which they are leasing regardless if it is one document or two separate documents.
5. The Lessee being responsible for maintaining the property.