

# TALES FROM THE TRENCHES™

## BY BARRY C. MCGUIRE

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June, 2012

### YOU DON'T KNOW WHAT YOU DON'T KNOW

I once received a voicemail and a couple of e-mails from someone who had been approached to invest in what he described as a rent-to-own. Could I help? Details were a little sketchy on the phone call and in the e-mails, so I asked that the documentation be sent to me and I would have a quick look. As always, names have been changed to protect the parties. Tales will never name names so that investors understand they can tell their Tales, help others, and be confident that their privacy is protected. This is about learning, not embarrassing.

The material our investor sent me is so very instructive that I have included it in our Tales handout. So, for the purposes of this Tale, please read the next two documents. The first document has the 'details' of the agreement between the parties. The second document is, or purports to be, a promissory note.

#### **Agreement between Brand New Investor (Brand New) & Rent to Own Inc. (RTO Inc.)**

Date: May 30, 2012

Brand New will be investing \$10,000 into the company and the money will be used to invest in real estate, specifically to acquire property(s) under contract for rent-to-own investing.

Brand New & RTO Inc. will split the profits from the rent-to-own in which her money is invested. He understands that the money will be invested for 1–3 years and that the return on investment is not yet determined.

RTO Inc. is prepared to pay him 10-18% once annually until the money is paid back in full. This will be paid up front but will come off his portion of the profits. A promissory note will be issued by RTO Inc. to Brand New as an addendum to this agreement as an instrument of security in acknowledgment of receipt of funds.

Both parties understand that there are many variables involved in the rent-to-own market and are prepared to work together. Brand New is putting up the \$10,000 and RTO Inc. will do all that is necessary to carry out the plan that is agreed upon, to the best of it's (sic) ability.

RTO Inc.

Sign:

Date:

Brand New

Sign:

Date: May 30, 2012

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### PROMISSORY NOTE

**PRINCIPAL: CAD \$ 10,000**

**DATE: 06/01/2012**

**Address for Payment: 123 Bad Investment Crescent, Grande Cache, Alberta**

**FOR VALUE RECEIVED, RTO Inc.** (the “borrower”) promise to pay to Brand New (the “Holder”), or order, at the above noted address for payment, the Principal, in lawful money of Canada, with 10-18% interest annually

The principal sum and interest thereon shall be due and payable as follows:

- (a) no principal payments prior to the earlier of default or *06/01/2015*
- (b) interest payments in arrears commencing on *06/01/2013*
- (c) the remaining principal and interest outstanding, if any, shall immediately become due and payable without any further notice or demand; provided that
- (d) the Holder shall have the option to accelerate the full principal and interest balance outstanding in the event of any default in payment which is not rectified after fourteen (14) days written notice thereof including a demand for rectification.

All payments shall be applied first to reasonable enforcement costs (if any, including reasonable legal fees on a solicitor and his own client basis), then to interest, and then to principal.

The principal balance outstanding from time to time shall be fully open and may be prepaid at any time and in any amount without notice, bonus or penalty, provided any such principal repayments shall be applied to the ultimate principal balance outstanding, and shall not reduce or affect the payments required above unless such payment is sufficient to retire all principal, interest and costs in full.

The Holder may assign all of its right, title and interest in, to and under this Promissory Note. All payments required to be made hereunder shall be made by the Borrower without any right of set-off, deduction or counterclaim.

DATED at Grande Cache, in the Province of Alberta effective the 01 June, 2012.

Well, what do you think? Ready to dive right in, sorry that you aren't getting in on the ground floor? No? When I finished reading these two sheets of paper I was stunned, gob smacked, thunderstruck and a couple of other things, none of them good. In all my years of practicing law I have never seen such a dangerous mess of concept and document.

Without going at it too hard, we don't know whether this is a loan or a share purchase, the interest rate is a maybe and the amount of money isn't enough to do any type rent to own purchase let alone more than one.

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There are probably five or six other fatal flaws.

If there is disagreement between the parties, my legal advice is that the document is unenforceable and probably void because of vagueness and uncertainty. What these two scraps of paper scream at me is that RTO Inc. is inexperienced with a complete lack of training and understanding.

Here's what's worse. Our member lost his spouse recently, is working three jobs to make ends meet, is trying to renovate his home so that his disabled brother can live with him and he needs money. He doesn't own any investment property and his mortgage broker told him his debt load is too high to qualify for a mortgage. He thought this was a good way to get started in real estate and quickly raise capital to help with his financial needs. R2O Inc. seemed nice. When I asked probing questions, Brand New really had no hard information about R2O Inc. other than "I met him at a seminar."

As a lawyer, my advice-giving style is to try and work with a situation. I almost always see things as neither black nor white; there is usually a nugget or two, something positive, something that could be improved and let's move forward. In this case I was uncharacteristically but, I think, quite properly, very definitive. Brand New and I had another conversation. Here's what I said. "Do not do this deal. Do not ask for clarifications or improvements. You will lose your money. Run away!!!" Now, what to say overall? There are so many critical observations to make but let's go with three very important ones.

### Lessons Learned:

1. Rent to own/lease options are a senior strategy. DO NOT attempt this strategy as your first, second or even third step into real estate.
2. You must do serious, in-depth diligence on the background and experience of anyone you propose to do business with.
3. Brand New called me because his son suggested, "you better check with a lawyer." When someone solicits you for money and you have no experience ALWAYS check with your lawyer.

Have Questions? [RMLO LAW LLP](#) has Answers!  
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