

## Unit 11: Real Estate Contracts

### LECTURE OUTLINE

- I. Contract Law—a contract is a voluntary agreement or promise between legally competent parties, supported by legal consideration, to perform (or refrain from performing) some legal act
  - A. Express and implied contracts
    1. Express contract—the parties state the terms and show their intentions in words.
    2. Implied contract—the agreement of the parties is demonstrated by their acts and conduct.
    3. Statute of frauds requires real estate contracts to be in writing.
  - B. Bilateral and unilateral contracts
    1. In a bilateral contract, both parties promise to do something for the other; a bilateral contract binds all parties and is enforceable against all parties.
    2. In a unilateral contract, one party promises to do something to induce a second party to do something; a unilateral contract is binding on and enforceable against only one party.
  - C. Executed and executory contracts
    1. Executed contract has been fully performed.
    2. Executory contract requires some performance by one or more parties before it is completed.
  - D. Creation of a valid contract (Figure 11.1)
    1. Offer and acceptance—mutual assent or meeting of the minds. *Letter of intent* may be used to begin negotiating before an offer is made. Offer may be terminated by the following:
      - a. Rejection, which may be made by the making of a counteroffer
      - b. Failure to accept within prescribed time period
      - c. Revocation by the offeror before acceptance
    2. Consideration—something of legal value; that which is "good and valuable" between the parties. Courts do not inquire into the adequacy of consideration.

3. Consent—parties must be able to make a prudent and knowledgeable decision without undue influence. May be absent because of a mistake, misrepresentation, fraud, undue influence, or duress.
4. Legal purpose—purpose of agreement must not violate any law.
5. Legally competent parties—of legal age and sufficient mental capacity to understand their actions

E. Validity of a contract

1. Valid—complies with the essentials of a valid contract and is binding in a court of law.
2. Void—has no legal effect (never was a contract); lacks essential elements of a valid contract.
3. Voidable—appears valid but may be disaffirmed or voided by one party based on some legal principle.
4. Unenforceable—neither party may sue for performance, but still may be treated as valid between the parties.

II. Discharge of Contracts—contract is discharged when terminated by complete performance, a party's breach or default, or other reason.

A. Performance of a contract

1. "Time is of the essence" means the contract must be performed within the stipulated time.
2. If no time is stipulated, it should be performed within a reasonable time.

B. Assignment—transfer of rights or duties under a contract; generally, to a third party (assignee)

C. Novation—substitution of a new contract for an existing contract

D. Breach of contract—violation of any of the terms or conditions of a contract without legal reason

1. If the seller defaults, the buyer may take one of the following actions:
  - a. Sue the seller for specific performance.
  - b. Sue the seller for damages.
2. If the buyer defaults, the seller may take one of the following actions:
  - a. Sue the buyer for the purchase price; this is the equivalent of a suit for specific performance.

- d. Sue the buyer for damages—may be limited to the *liquidated damages* stated in the agreement.
    - 3. Statute of limitations—the time limit in which to enforce rights; time varies for different legal actions, rights not enforced within time period are lost
  - E. Other reasons for termination—contracts may be discharged or terminated when any of the following occur:
    - 1. Partial performance—with written acceptance by non-breaching party
    - 2. Substantial performance—may be sufficient to force payment with certain adjustments
    - 3. Impossibility of performance—legally impossible to perform the required act
    - 4. Mutual agreement of the parties to cancel the contract
    - 5. Operation of law, such as the voiding of a contract by a minor, result of fraud, improper alteration of the contract, or expiration of statute of limitations
    - 6. Rescission—one party may rescind the contract and return the parties to their original positions; monies that have been exchanged must be returned
- III. Contracts Used in the Real Estate Business—written agreements most commonly used by real estate professionals are:
- \* Client representation agreements
  - \* Real estate sales contracts
  - \* Options
  - \* Escrow agreements
  - \* Property management agreements
  - \* Leases
  - \* Owner financing contracts (such as land contracts, contracts for deed)
- A. Use of contract forms
    - 1. Each state has different requirements.
    - 2. A real estate licensee who is not a licensed attorney may not practice law; i.e., draw up a contract.
    - 3. Preprinted forms are commonly used.
    - 4. In Practice: Students should become familiar with various types of contracts used in the area; parties should have their attorneys review contracts to ensure documents reflect their understanding
  - B. Sales contracts—may be called offer to purchase, contract of purchase and sale, purchase agreement, earnest money agreement, or deposit receipt.

1. The sales contract is the most important document in a sales transaction because it establishes the legal rights and obligations of the buyer and seller; it dictates the contents of a deed.
  - a. Offer—typically presented by buyer or buyer's representative to the seller or seller's representative.
  - b. Counteroffer
    - (1) Original offer ceases to exist.
    - (2) Other party may accept or reject counteroffer.
    - (3) Counteroffer may be withdrawn at any time before it has been accepted.
  - c. Acceptance—required to create a contract.
    - (1) If accepted as written, the contract is created and a signed copy must be given to all parties.
    - (2) Notification of acceptance must be given to the party who made the offer (or counteroffer) before the contract is considered created.
  - d. Binder—used in some areas as a "short form" sales contract
  - e. Earnest money deposit—evidence of the buyer's intention to carry out the terms of the contract
    - (1) Should be held by the broker, escrow agent, or attorney in a trust or escrow account
    - (2) Amount to be agreed upon by buyer and seller
    - (3) Should show how interest earned (if any) will be distributed
    - (4) Should be of a sufficient amount to discourage the buyer from defaulting and compensate the seller for taking the property off the market
  - f. Equitable title—after the contract is created but before the deed is delivered, the buyer may have an insurable interest in the property being purchased
  - g. Destruction of premises—depending on the jurisdiction, either the seller or the buyer can be responsible for the property after the contract is created but before the deed is delivered
  - h. Liquidated damages—commonly, the contract specifies that the earnest money will be used as liquidated damages to compensate the seller if the buyer breaches the contract

C. Provisions of a sales contract

1. Identification of the buyer and statement of the buyer's obligation to purchase
2. An adequate description of the property, such as street address
3. Identification of the seller and the statement of the type of deed the seller will give, including any covenants, conditions, and restrictions
4. Purchase price and financial arrangements for its payment, including amount and form of down payment or earnest money
5. Identification of closing or settlement agent and closing or settlement instructions
6. Date for closing and transfer of possession to the buyer
7. Title evidence that will be satisfactory to the buyer
8. Provisions for prorations
9. Outcome of the contract should the property be damaged or destroyed between time of signing and closing date
10. Remedies in the event of a breach of the contract
11. Contingencies or conditions of the sale
12. Personal property to be included in the sale
13. Fixtures or other real estate items that are not included in the sale
14. Transfer of any applicable warranties on equipment or appliances
15. Identification of any leased equipment to be transferred to buyer or returned to lessor
16. Transfer or payment of any outstanding special assessments
17. Buyer's right to inspect the property shortly before closing
18. Documents to be provided by each party and place/time for delivery
19. Dated signatures of all parties

D. Contingencies—additional conditions that must be satisfied before a sales contract is fully enforceable (include examples of those commonly used in your area)

1. Elements include;
  - a. Action necessary to satisfy the contingency
  - b. Time frame within which the action must be performed
  - c. Any cost involved and party responsible for payment
2. Acceptance of a contingency by the seller may require buyer to agree to an escape clause that allows the seller to continue marketing the property until all contingencies have been removed. Common contingencies are
  - a. Mortgage
  - b. Inspections
  - c. Property sale by buyer
  - d. Lienholder approval, if purchase will be a short sale

E. Amendments and addendums

1. An amendment is a change to existing content of a contract.
2. An addendum is an additional, new provision to a contract.

F. Disclosures of property conditions, either by custom or as required by state law

G. Options

1. An option grants the right to buy or lease property at a fixed price within a stated period of time
2. Residential lease option may provide for a portion of the lease payment to be applied to the purchase price if option is exercised.
3. Option on commercial property may depend on a condition being fulfilled, such as obtaining a zoning change or building permit.

H. Owner financing contracts: Land contracts (contract for deed, contract of sale, conditional sales contract, bond for title, installment contract, land sales contract, or articles of agreement for warranty deed)

1. Seller/vendor retains legal title to the property.
2. Buyer/vendee receives possession and equitable title; becomes responsible for paying principal, interest, real estate taxes, hazard insurance premiums, and maintenance and repairs on the property, depending on terms of the contract.
3. Seller delivers the deed when the terms of the contract have been met, usually full payment of the contract amount.