

Alpha College of Real Estate
1 HOUR
CONTRACTS CORRESPONDENCE/INTERNET COURSE



**1 Hour of Contracts
Continuing Education
Correspondence/Internet Course**

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REAL ESTATE CONTRACTS (1HOUR)

ESSENTIAL ELEMENTS

In order for a contract to be **legally valid**, and hence binding and enforceable, the following five requirements must be met:

Legally competent parties
Mutual agreement
Lawful objective
Consideration or cause
Contract in writing when required by law

If these considerations are met, any party to the contract may, if the need arises, call upon a court of law to either enforce the contract as written or award money damages for nonperformance. In reality, a properly written contract seldom ends in court because each party knows it will be enforced as written. It is the poorly written contract or the contract that borders between enforceable and unenforceable that ends in court. A judge must then decide if a contract actually exists and the obligations of each party. Using the courts, however, is an expensive and time-consuming method of interpreting an agreement. It is much better to have a correctly prepared contract in the first place.

In order for a contract to be legally enforceable, all parties entering into it must be **legally competent**. In deciding competency, the law provides a mixture of objective and subjective standards. The most objective standard is that of age. A person must reach the age of **majority** to be legally capable of entering into a contract. **Minors** do not have contractual capability. In most states the age for entering into legally binding contracts is 18 years. The purpose of majority laws is to protect minors from entering into contracts that they may not be old enough to understand. Most contracts made with minors, except those for **necessities**, such as food and clothing, are voidable by the minor at the minor's option, and remain voidable at the minor's option for a reasonable time after attaining the age of majority. However, if the adult was unaware of the minor's status, the contract may be voidable at the option of either party.

Regarding **intoxicated persons**, if there was a deliberate attempt to intoxicate a person for the purpose of approving a contract, the intoxicated person, upon sobering up, can call upon the courts to cancel the contract. If the contracting party was voluntarily drunk to the point of incompetence, when he is sober he may ratify or deny the contract if he does so promptly. However, some courts look at the matter strictly from the standpoint of whether the intoxicated person had the capability of formulating the intent to enter into a contract. Obviously, there are some fine and subjective distinctions here, and a judge may interpret them differently than the parties to the contract. The points made in this paragraph also apply to a person who contracts while high on marijuana or other legal or illegal drugs.

Persons of **unsound mind** who have been **declared incompetent** by a judge may not make a valid contract, and any attempt to do so results in a **void** contract. The solution is

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to contract through the person appointed to act on behalf of the incompetent. If a person has **not** been judged legally incompetent but nonetheless appears incapable of understanding the transaction in question, the contract may be **voidable** at the option of the court or the court-appointed guardian. If a person is judged to have been **lucid** upon entering into a contract, the contract remains valid even though he/she is later declared incompetent.

The requirements of **mutual agreement** (also called **mutual consent**, or **mutual assent**, or **meeting of the minds**) means that there must be agreement to the provisions of the contract by the parties involved. In other words, there must be a mutual willingness to enter into a contract. The existence of mutual agreement is evidenced by the words and acts of the parties indicating that there is a valid offer and an unqualified acceptance. In addition, there must be “**reality of consent**” meaning there is no fraud, misrepresentation or mistake, and the agreement must be genuine and freely given.

STATUTE OF FRAUDS

The **Statute of Frauds** is based on the original English Statute for Prevention of Frauds and Perjuries of 1677. The Statute of Frauds requires that all contracts for the sale of land or any interest exceeding one year be in writing and signed by the parties to be enforceable.

Real estate transactions are governed under the Statute of Frauds because, for one reason, no two parcels of land are exactly alike. Virginia contract law prevents the enforcement of an oral contract or promise. When a deed is in writing, there is no chance of error and this is important because there is no substitute for a particular parcel of real estate. Leases for one year or less are not required to be in writing in order to be enforceable.

§ 54.1-2101.1. Preparation of real estate contracts by real estate licensees.

Notwithstanding any rule of court to the contrary, any person licensed under this chapter may prepare written contracts for the sale, purchase, option, exchange, or rental of real estate provided the preparation of such contracts is incidental to a real estate transaction in which the licensee (i) is involved and (ii) does not charge a separate fee for preparing the contracts.

(1997, cc. 200, 231.)

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PURCHASE AGREEMENTS

Purchase contract, purchase offers or sales agreement.

Bilateral, executory contract.

In other words, the parties do not fully perform their obligations at the time the agreement is signed.

Equitable title

Once the parties have signed the purchase agreement, the buyer acquires an interest in the property. This right should not be confused with legal title, which is the buyer's evidence that he is the rightful owner. Equitable title simply means the buyer has the ultimate right to receive legal title.

Legal title,

is conveyed at closing by the seller delivering a properly executed deed to the buyer.

Merges with the deed

Not only does the sales contract establish the legal rights and obligations of the buyer and seller, but it also determines what goes into the deed. At closing, the sales contract as title passes to the buyer. The sales contract becomes a dead instrument. In some cases it is important that the sales contract not merge with the deed and continue to be an enforceable contract after closing.

Survival clause,

This provision prevents the contract, or any specific covenant in the contract, from merging with the deed.

TYPICAL PROVISIONS

The typical provisions found in a form contract are as follows:

DATE:

Although not an essential element, it is important to establish the date an offer is made because offers will expire after the lapse of a reasonable period of time.

PARTIES:

A sales contract must name a legally competent buyer and seller if the agreement is to be enforceable. The seller should be named exactly since he is to execute the deed of conveyance, the buyer should be named exactly since he plans to accept title.

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MUTUAL AGREEMENT:

There must be an agreement by the seller to sell and an agreement by the purchaser to buy the property in question. The absence of such an agreement may void the contract since the exchange of promises compromises the consideration

LEGAL DESCRIPTION:

An enforceable contract must contain a legal description, which unquestionably identifies the property to be bought and sold. It is preferable to use a legal description furnished by the seller. If there is a dispute later as to the validity of the description, the broker would not be held liable for negligence in preparing the contract. A street address may be included to further identify the property, but it should not be relied upon as a complete legal description.

All improvements, appurtenances, and fixtures on the described land are automatically included in the sale. Disputes often arise, however, because it is unclear whether certain items are personal property or fixtures. Misunderstandings and possible legal problems can be avoided by listing in the contract those items that could possibly be construed as personal property. Items such as drapes, appliances, and mirrors frequently are sources of disputes concerning ownership. It should also be made clear that the items listed are to be included in the purchase price, or excluded as the case may be.

PRICE AND TERMS:

A definite purchase must be stated in the contract. If the purchase requires the buyer to obtain financing, the contract should state the exact loan amount, interest rate, plus the number of years over which the loan is to be repaid. Where the purchaser is to take over the seller's existing loan, the contract should specify how and when the seller's equity is to be paid and the buyer's liability for repayment of the loan.

EARNEST MONEY:

Earnest money is the buyer's initial deposit, which serves as evidence of intent to fulfill his obligations under the contract. It is not essential in order to create a binding contract. While it is customary for earnest money to be paid by check or in cash, it may be a promissory note due and payable at or before closing, or it may be a money order, certificate of deposit, or other things of value. The form of earnest money must be disclosed in the contract. Otherwise, the broker is held liable if the deposit proves of no value. For example, if the broker accepted a promissory note and failed to disclose this fact to the seller, the broker may be required to pay the note if the buyer defaulted. The broker must have the seller's permission to accept an earnest money deposit that is not readily negotiable.

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The amount of the earnest money deposit and who is to hold the deposit are negotiated between the buyer and seller. If the earnest money is to be held by a broker, it must be **promptly** deposited into the broker's escrow account upon the creation of a valid contract.

Note: VREB Regulation requires upon contract ratification, earnest money deposits and down payments be placed in an escrow account by the end of the 5th business banking day unless otherwise agreed to in writing by the parties to the transaction.

TYPE OF DEED:

The type of deed the seller agrees to deliver at closing should be specified in the contract. Deeds typically named for this purpose are general warranty, special warranty, bargain and sale, grant, and quitclaim. If the type of deed is not specified, the seller would be allowed to use a special warranty deed or a quitclaim deed, depending on the particular state.

MARKETABLE TITLE:

Generally, the contract states that the seller agrees to convey a good and marketable title to the buyer at closing. A **marketable title** is one insurable by a title insurance company at its regular rates. It is a title free from defects leaving no doubt as to who the owner is. Title is generally conveyed, subject to certain existing encumbrances and restrictions.

DESTRUCTION OF THE PREMISES:

If the property is destroyed or substantially damaged by fire or other casualty before the transaction is closed (i.e., while the buyer has equitable title), some states place the burden of loss on the buyer. Other states have enacted the Uniform Vendor and Purchaser Risk Act, which places the risk of loss on the seller (vendor) until the buyer is given possession of the property.

PROPERTY CONDITION:

Buyer usually accepts property in its present condition unless otherwise agreed to.

Home Inspection and Walk through Clauses:

These clauses typically allow for inspection by a professional prior to closing

CONTINGENCIES:

Termite Inspection, Lead Base Paint Inspections, Property Owners Associations

DISCLOSURES:

Agency, Virginia Residential Property Disclosure Act, Mechanics Lien

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POSSESSION:

The date the buyer may take possession of the property should be specified in the contract by agreement. If the contract is silent as to the date of possession, the right of possession is granted to the buyer with delivery of the deed.

CLOSING DATE:

A closing date agreeable to both parties should be stated in the contract along with the exact time and place, if known. The closing date should be set with consideration given to the type of financing involved and to the time needed for an attorney to prepare evidence of good title. For instance, more time is usually needed when new financing is required than when an existing loan is assumed. If a specific date is not mentioned, then the parties would have a reasonable time to close the transaction. In order to ensure that a date is faithfully observed, the phrase “**time is of the essence,**” must be included.

BROKER’S COMMISSION:

This provision recognizes the broker as the one who negotiated the transaction and assures him of his commission if either party defaults.

SIGNATURES:

For a sales contract to be enforceable, it must be properly signed by all the parties.

POWER OF ATTORNEY:

In Virginia, the power of attorney must specify the transaction and the parties involved: a general power of attorney will not suffice. The power of attorney must be notarized and recorded with the deed.

OPTIONS

An **option** is a unilateral contract which involves either the right to buy or the right to lease real estate. The owner or lessor is called the **optionor**; the prospective buyer or lessee is the **optionee**. In an option, the optionor grants the optionee an irrevocable and exclusive right to buy or lease the optionor’s property at a fixed price within a **specified period of time**. For the option to be enforceable it must be in writing and signed by the optionor. Also, the optionee must pay the optionor a **valuable consideration**. Although it is customary for option money to be applied to the purchase price (or rent) when the option is exercised, it is always a matter of negotiations. Option money purchases “time” and does not provide the optionee with an interest in the property.

The optionee assumes no obligation with an option other than payment of the consideration. Should he choose to exercise his right, the optionor is obligated to sell or lease at a fixed price. If not exercise within the time period specified, the option expires and all option money is forfeited.

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LEASES

A lease is a bilateral contract involving two parties: the **lessor** (usually the owner) and the **lessee** (also called the tenant). Under a lease the lessee agrees to pay the lessor rent for the exclusive right to possession and control of certain property. A special lease agreement, known as a **sale-leaseback** agreement, is used primarily for financing commercial properties. It is typically used by owners who want to raise additional capital for their business. The property is sold to an investor with the right to lease it back and continue the business. Rights and obligations of the parties in a lease are discussed in more detail in a later chapter.

LAND CONTRACT

A **land contract** is also known as an **installment contract** and **contract for deed**. This type of contract is usually used when sufficient financing is not available to the buyer from a lending institution. It may be used to buy any type of real estate, not just land. When a land contract is used, the buyer usually makes a small downpayment, takes possession, and agrees to pay taxes, insurance, and installments of principal and interest to the seller over a long period of time. The main feature of this arrangement is that the seller retains legal title as security for payment of the full purchase price. The buyer is not entitled to the deed until all installments have been made and all other obligations under the contract fulfilled. While the land contract is executory, the buyer has **equitable title**.

A **right of first refusal**, or first right of refusal (FRR), is the right of a person to have the first opportunity either to purchase or lease real property. Unlike an option, however, the holder of a right of first refusal has no right to purchase until the owner actually offers the property for sale.

Under an option to purchase, the optionee can decide whether or not to exercise the option at a fixed price during the option period. In a right of first refusal, however, the holder can exercise the right, only **if** the owner has decided to sell or lease the property.

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CONTRACT REVIEW QUESTIONS

1. What contract form are you using, are you familiar with its pre-printed terms?
2. Are you using the correct legal names, and addresses of the buyer's and sellers?
3. Are you using the correct and complete legal description of the property?
4. How are the buyers going to take title?
5. Are the buyers and sellers using a power of attorney and do you have a copy?
6. What real and personal items are conveying? The listing is not always correct. Are the items conveying in "as is" condition?
7. Does your financing terms add up?
8. Who is going to hold the earnest money deposit?
9. Will you need a "time is of the essence" clause or is approximate closing date ok?
10. Who is paying the closing cost, points, pre-paid item, MIP, VA funding fee? On an assumption, who pays the next payment due? Will the points have to be locked in with the mortgage company and who will do that?
11. Who is the settlement agent and who picks the settlement agent? Will you use an Attorney or a lay settlement company?
12. Contingency clause's, who has the right to void and when?
13. Will the buyer need or want a home inspection, Termite inspection or other inspections, i.e.; well, septic? Will the inspector have to be licensed?
14. Who will pay for the cost of repairs required by the appraisal or home inspections? Will there be a limit to the cost of these repairs paid by either party? Does the repair require a permit or the contractor to be licensed?
15. Does the age of the property, built prior to 1978, require a lead base paint disclosure?
16. Are the appropriate Home Owners Association and or Condo language included in the contract?
17. Have all of the applicable disclosures been made, i.e. environmental, flood plain, Historical District, property condition, state or federal required?

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CONTRACT CASE STUDIES AND ANSWERS

1. Question: The seller is presented an offer exactly meeting his asking price and terms. He refuses to accept the offer. Does the buyer have any cause of action against the seller?

Answer: The buyer has no cause of action against the seller; there was no contract with the seller. Only the listing company may have cause against the seller for commissions.

2. Question: The buyer writes an offer, through his agent, stating on the face of the offer that the offer expires at noon on March 15th, 03. The seller accepts the offer at 1 pm on March 15th, 03. What is the status of the offer?

Answer: The offer died at noon. The seller has made a counteroffer, and it is now up to the buyer if he wants to accept it.

3. Question: The purchaser submits an offer, but it has no earnest money specified. Is this offer valid or void?

Answer: The offer is valid. The Purchase price is the consideration. The only reason for earnest money is to have some of the purchaser's money up front if he should default. Earnest money is not needed to form a valid contract.

4. Question: A sixteen-year-old boy entered into a contract to purchase real estate with the owner, who was a man some forty-five to fifty years old. The seller changed his mind and wanted to void the contract. He said he could do so because the buyer lacked legal capacity to contract since he was a minor. Can he do so?

Answer: no, the minor, not the adult, can only void the contract.

5. Question: Sam Buyer comes to town without his wife seeking a home to buy. He finds one he likes and tells the agent he is ready to sign an offer for it with a financing contingency. The agent tells him that his wife will need to sign the offer to make it legal. Sam Buyer tells the agent his wife is unemployed, earns no income and he has the money for the down payment in an account under his name only and he can qualify for the house on his income. He states he does not need his wife's signature to buy. Who is right, the agent or Sam Buyer?

Answer: Sam is a married person can purchase property in his/her name only. There would be two reasons to obtain the wife's signature. (1), if her income is needed to qualify for the loan or (2), a sales tool. Neither applies in this case.