Contract for Sale: The Most Important Document in Real Estate

- Determines price and terms of the transaction
- Defines property interest being conveyed
- Determines the grantee
- Determines other conditions of the transaction
  - Financing
  - Date of occupancy
  - Any repairs or other conditions of the sale

Required Elements of a Contract

- All contracts:
  - Competent parties
  - Legal objective
  - Offer and acceptance
  - Consideration
  - No defects to mutual assent
- Contract for sale of real estate:
  - In writing (per Statute of Frauds)
  - Proper description of property

A Closer Look at Requirements

- Competent parties
  - Of legal age
  - Not incapacitated at time of signing
  - Appropriate official if representing a corporation
  - Power of attorney if acting for another person
- Lawful intent
- Offer and acceptance
- Consideration
- No defects to mutual assent
- In writing
- Legal Description should be used

Legal vs. Equitable Title

- Legal title: Ownership of a freehold estate
- Equitable title: Right to obtain legal title
- Buyer obtains equitable title when a contract for sale of real estate is fully signed

Would This Be a Valid Contract?

I, Ben Buyer, agree to buy and pay $20,000, and I, Cecil Celler, agree to sell the parcel of real estate at 1013 NE Seventh Road in North Platte, Nebraska.

Ben Buyer:  
Cecil Celler: 

- Competent parties?
- Legal objective?
- Offer and acceptance?
- Consideration?
- Defects to mutual assent?
- In writing?
- Valid description?
Problems with This Contract?

1. Ben Buyer, agree to buy and pay $20,000, and I, Cecil Celler, agree to sell the parcel of real estate at 1013 NE Seventh Road in North Platte, Nebraska.

Ben Buyer: [Signature]
Cecil Celler: [Signature]

- What are boundaries of 1013 NE Seventh Road?
- When is the closing?
- When does Ben get possession?
- Cash sale? Earnest money deposit?
- Must Cecil deliver marketable title?
- Is a quitclaim deed acceptable?
- Are there structures? Condition now? Condition at closing?

Advantages of Form Contracts

- Neutral (not prepared by opposite party)
- Ready-made treatment of details
- Prorations
- Inspections
- Performance dates
- Many others
- Local real estate boards are a good source
- Up-to-date with current relevant law
- Adapted to locally important issues
- Radon risk
- Flood plain
- Insulation quality
- Water supply
- Generally neutral between the buyer and seller

Risks with Standard Form Contracts

- May treat some issues too lightly
- Perpetual struggle on contract detail
  - Attorneys: More detail reduces future disputes
  - Brokers: Long contracts put a chill on negotiations
  - Resolution: Bar Assn. Realtors jointly drafted contract form
- Inappropriate and inadequate application of a form contract:
  - Residential contract for apartment property
  - Residential contract for undeveloped land

Components of a Form Contract

- Part I: Points particular to the deal
  - Items to be negotiated (price, date of closing, distribution of expenses)
  - Items that characterize the property (water source, zoning, flood zone status)
- Part II: Items that must be clear (the same for most transactions)
  - Provisions for survey
  - Proration procedure
  - Disbursement of funds
  - Recourses in case of default

Handling of Funds

- Broker normally handles funds for a transaction
- Broker must put deposits in escrow
  - Escrow account: An account holding funds dedicated for a particular purpose
  - Must be with insured institution or title company
- At closing, money is disbursed in accordance with a closing statement

Contract Terminology

- Contingent contract: Obligation of a party to perform depends on one or more conditions being met
- Assignment: One party’s contractual rights and obligations are transferred to someone else
  - Does not relieve assignor of liability
  - Can be explicitly prohibited
Contract Terminology (continued)

- Escrow agent: Third party who holds moneys or documents on behalf of contract parties
  - Distributes items in accordance with contract
  - Can be attorney, financial institution, or title company

Remedies of Buyer and Seller

- Suit for damages: Always an option to both parties
- Specific performance: Buyer can force seller to convey title
- Liquidated damages (seller): Seller can retain deposit if buyer backs out
- Rescission: Mutual agreement to cancel

Roles of Brokers and Lender in the Transaction

- Selling broker: No legal role after contract is signed; facilitator for buyer
- Listing broker:
  - May handle closing if no lender is involved
  - May assist in retaining services for seller
- Lender:
  - Requirements
  - Often handles closing

Real Estate Settlement Procedures Act

- Applies to virtually every home loan:
  - Loans from federally chartered or insured institutions
  - FHA and VA loans
  - Loans to be sold to Fannie Mae or Freddie Mac
- Requirements:
  - Borrower to be provided information booklet
  - Borrower receives good faith estimate of closing costs
  - Closing statement must be HUD-1 form
  - Closing statement available 24 hours before closing
  - Kickbacks to closing-related vendors are prohibited
  - Limit to lender escrow deposit requirement

Financial Items in a Closing

1. Purchase price  Buyer pays
2. Earnest money deposit  Buyer has prepaid
3. Assumed mortgage  Buyer takes over from seller
4. Purchase money mtg.  Seller loans to buyer

Prorated Items

- Seller pays, receives credit
- Buyer pays, receives credit
- Seller paid, receives credit
- Buyer paid, receives credit
- Paid by seller

Title insurance – owner’s  Paid by seller
Title insurance – lender’s  Paid by buyer
Attorney – buyer  Paid by buyer
Attorney – seller  Paid by seller
State doc. tax – Mtg.  Paid by buyer
State doc. tax – Deed  Generally paid by seller
Intangibles tax – Mtg.  Paid by buyer
Recording of new mtg.  Paid by buyer
Recording of deed  Paid by buyer
Brokerage commission  Paid by seller
### Proration – Property Tax: Example

- **Closing date:** May 14 (365-day year)
- **Annual property tax:** $500

<table>
<thead>
<tr>
<th>Seller’s days</th>
<th>Buyer’s days</th>
</tr>
</thead>
<tbody>
<tr>
<td>133 days</td>
<td>232 days</td>
</tr>
</tbody>
</table>

| Jan. 1 | May 14 | Dec. 31 |

**Seller’s share of tax:** \( \frac{133}{365} \times 500 = 182.19 \)

### Proration of Insurance: Example

- **Closing date:** March 16 (365 day year)
- **Prepaid Insurance:** Dec. 15 to Dec. 14, $250 per year

<table>
<thead>
<tr>
<th>Seller’s days</th>
<th>Buyer’s days</th>
</tr>
</thead>
<tbody>
<tr>
<td>91 days</td>
<td>274 days</td>
</tr>
</tbody>
</table>

| Dec. 15 | Mar. 16 | Dec. 14 |

**Buyer’s share of insurance:** \( \frac{274}{365} \times 250 = 187.67 \)

### Good Faith Estimate of Buyer’s Closing Costs

- [Form Image]

- [Form Image]

- [Form Image]
Preclosing Steps of Buyers (Joneses)

- Had property surveyed for encroachments
- Reviewed private restrictions for violations
- Reviewed zoning for neighborhood
- Examined estimated closing costs
- Ordered lenders title insurance
- Had property inspected
- Verified that seller has performed required tasks
- Arranged utility service transfers

Preclosing Steps of Sellers (Johnsons)

- Order owner’s title policy
- Order termite inspection
- Order discontinuation of hazard insurance and utilities

Preclosing Steps of Closing Agent (Lender)

- Prepare or obtain general warranty deed
- Prepare mortgage and note
- Prepare check from lender to the seller
- Prepare HUD-1 closing statement
- Obtain satisfaction of mortgage from sellers’ mortgagee confirming balance

HUD-1 Settlement Statement
End of Chapter 13