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

- Competent parties
- Legal objective
- Offer and acceptance
- Consideration
- No defects to mutual assent

- Contract for sale of real estate:
  - Written (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: [Signature]
Cecil Celler: [Signature]

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

- 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?  
- Any fixtures (e.g., fences)?  
- Is Cecil married?  
- 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

Sales Contract - 1

Deposit receipt

<table>
<thead>
<tr>
<th>Legal description</th>
<th>Addressing fixtures problem</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>
Sales Contract - 2

Terms of the offer

Counter offer

Offer contingent upon radon and construction inspection

Sales Contract - 3

Closing date

Deal is contingent on obtaining loan: fixed rate, 30 years, $121,600, 6.75 percent.

Sales Contract - 4

If existing loan will remain, sale is contingent on a successful assumption

If buyer wants to assume the loan, they'll get at the application quickly

Who pays for the assumption? A limit to the assumption fee Sells comes up With the actual Note in 10 days

Sales Contract - 5

When does default occur? What right of prepayment?

What is the late fee?

What is the late fee?

Sales Contract - 6

What kind of Evidence of title From the seller? How quickly? How long can the buyer review it?

Sales Contract - 7

What about termites or fungus? Are any structures excepted from inspection?

How much damage before the contract is upset?

What if there is a problem?
If you are buying a vacant lot, does this tell you what you need to know?

Why does this matter?

If you are buying a house, does this tell you what you need to know?

What does the buyer pay for?

What does the seller pay for?

What kind of deed is acceptable?

When does the buyer get possession?

What is the seller's responsibility for latent defects?

How long does the seller have to respond to this offer?

Who owns the day of closing?

How long does the buyer have to obtain a survey?

What if the survey reveals an encroachment?

Who is qualified to inspect and repair the property?

What rights does the buyer have to inspect the property?

About systems and appliances?

What promises is the seller making about condition of the structure?

How much repair cost before the contract is in question?

What does the buyer pay for?

What does the seller pay for?

Is the property in a Flood zone?

What if it is, and the seller did not indicate it?

Buyer is to receive estimate of closing costs.

What if there is a Homeowner’s association?

Who is qualified to inspect and repair the property?

What rights does the buyer have to inspect the property?

About systems and appliances?

What promises is the seller making about condition of the structure?

How much repair cost before the contract is in question?

What kind of deed is acceptable?

When does the buyer get possession?

What if the survey reveals an encroachment?

How long does the buyer have to obtain a survey?

What is the seller’s responsibility for latent defects?

How long does a seller have to repair damage occurring after the contract is signed?
Sales Contract - 14

What are the remedies of the seller?

What are the remedies of the buyer?

How do you modify this contract?

Sales Contract - 15

Is time “of the essence,” i.e., does ANY breach of a deadline constitute default?

What must seller provide Concerning any leases?

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

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

- Time “of the essence,” i.e., does ANY breach of a deadline constitute default?

- What must seller provide Concerning any leases?

- 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
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
2. Earnest money deposit
3. Assumed mortgage
4. Purchase money mtg.
5. Interest on assumed mtg.
6. Existing insurance
7. Property taxes

- Buyer pays
- Earnest money deposit buyer has prepaid
- Buyer takes over from seller
- Seller loans to buyer
- Seller paid, receives credit
- Buyer pays, receives credit
- Buyer pays, receives credit

Financial Items in a Closing (continued)

- Title insurance – owner’s
- Title insurance – lender’s
- Attorney – buyer
- Attorney – seller
- State doc. tax – Mtg.
- State doc. tax – Deed
- Intangibles tax – Mtg.
- Recording of new mtg.
- Recording of deed
- Brokerage commission

- Paid by seller
- Paid by buyer
- Generally paid by seller
- Paid by buyer
- Paid by buyer
- Paid by buyer
- Paid by buyer

Proration – Property Tax: Example

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

Seller’s days
133 days
Jan. 1
Buyer’s days
232 days
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

Seller’s days
91 days
Dec. 15
Buyer’s days
274 days
Mar. 16
Dec. 14

Buyer’s share of insurance:
\[
\frac{274}{365} \times 250 = 187.67
\]

Good Faith Estimate of Buyer’s Closing Costs
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<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>000</td>
<td>Items Payable in Connection with Loan</td>
<td>$1,256.00</td>
</tr>
<tr>
<td>001</td>
<td>Origination Fee</td>
<td>$1,256.00</td>
</tr>
<tr>
<td>003</td>
<td>Appraisal Fee</td>
<td>$275.00</td>
</tr>
<tr>
<td>004</td>
<td>Credit Report</td>
<td>$39.00</td>
</tr>
<tr>
<td>006</td>
<td>Document Review</td>
<td>$395.00</td>
</tr>
<tr>
<td>007</td>
<td>Flood Certification Fee</td>
<td>$18.00</td>
</tr>
<tr>
<td>901</td>
<td>Interest for 31 days @ 22.49 per day</td>
<td>$697.82</td>
</tr>
<tr>
<td>902</td>
<td>First Year Mortgage Insurance Premium</td>
<td>$684.00</td>
</tr>
</tbody>
</table>

Paid By: Borrower

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

Settlement Statement