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CONTRACTS

REAL ESTATE BROKER

What you need to know...

HIGH SPEED INTERNET COMMUNICATION FROM A CLASSROOM SETTING
THAT REACHES AROUND THE STATE, THE COUNTRY & THE WORLD

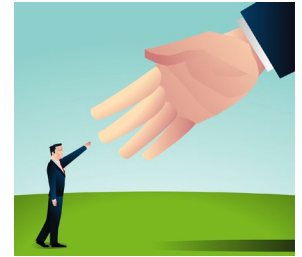
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What are contracts?

Basically, a contract is an agreement to do or not do something between different parties. In each agreement (contract) the parties spell out what they are willing to do or not do. There are times when confusion or misunderstandings occur due to **contract ambiguities** (unclear or contradictory statements) or the contract may not cover all points of interest and concern between the parties. These misunderstandings may lead to court actions.

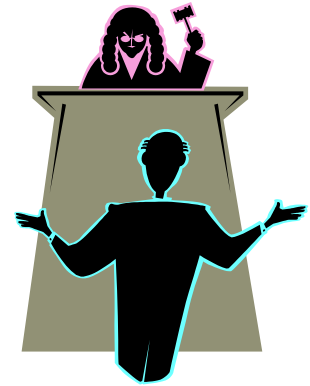
The importance of a properly constructed contract is critical. When disagreements arise between the parties, the courts are asked to review the contract and determine what the parties' intent was. In most instances the court will judge against the party who caused the ambiguities in the contract. And guess what? **The licensee is the one who wrote the contract for one of the parties and may be held responsible.**



Licenses And The Practice of Law

The legal world (in this case attorneys) are licensed to represent parties to contracts as part of their legal duties. They are protective of their profession and have sued real estate organizations in the past and charged that licensees are practicing law without a license when real estate professionals fill out listing contracts and buy/sell agreements, which they feel is illegal.

Courts have agreed but have permitted licensees to continue doing so **if it is done in pursuit of their livelihood and if standardized forms are used that only require filling in blanks**. Some states disagree and a lawyer is involved in all real estate transactions in those cases.



How the listing and buy/sell contracts are formed; what they must have in them; what the court looks at in a contract, etc. are important to licensees since a situation may arrive where the courts become involved.

A properly prepared contract legally binds competent parties to the terms of the contract. Real estate contracts include listing agreements, offers to purchase, sales contracts, options, binders, mortgages, notes, insurance policies, leases and property management agreements.

Types of Contracts

The buying, selling and leasing of real estate is, by its nature, based on contracts. These transactions are complicated and buying or leasing real property in many cases is the largest investment a person, couple or company will ever make. This is a huge responsibility for licensees and understanding contracts is critical to success.

Real estate contracts are the basis for settlement sheets, closing statements, types of deeds used to transfer ownership, the terms and conditions of a lease, etc. Two examples of real estate contracts follow:

(1)

RESIDENTIAL LISTING CONTRACT Exclusive Right to Sell



1 **THIS AGREEMENT IS INTENDED TO BE A LEGALLY BINDING CONTRACT. IF NOT UNDERSTOOD,**
2 **SELLER IS ADVISED TO SEEK THE ADVICE OF COMPETENT LEGAL COUNSEL.**

3

4 This Agreement is an exclusive right to sell listing and Broker is granted the absolute, sole, and exclusive
5 right to market and sell the Property.

6

(2)

BUY - SELL AGREEMENT (Including Earnest Money Receipt)



The use of this form is for REALTOR® members only (members of the Montana Association of REALTORS®) and cannot be used by any other party for any purpose. Use of these forms by other parties may result in legal action by the Montana Association of REALTORS®.

- 1 **This Agreement stipulates the terms of sale of this property. Read carefully before signing.**
- 2 **This is a legally binding contract. If not understood, seek competent advice.**



Valid & Enforceable Contracts



FOR THE COURT TO CONSIDER A CONTRACT VALID AND ENFORCEABLE IT MUST CONTAIN THE FOLLOWING ESSENTIAL ELEMENTS:

Legally Competent Parties

A person or organization entering into a contract has either full, limited or no capacity to do so.

Parties with full capacity to contract must be *legally and mentally competent and authorized or have the capacity to perform*.

FULL CAPACITY – is the unlimited ability of a person to enter into a legally binding contract. Adults, even those who are illiterate, have full capacity to contract.

LIMITED CAPACITY – a person's ability to enter into a contract that is legally binding upon him or herself only under certain circumstances. A minor has limited capacity, which means that the contract is valid only if the minor agrees.

NO CAPACITY – The inability of a person to enter into a valid contract under any circumstances. A person who has been adjudicated insane or a corporate officer who has no authority to sign a contract.

Offer & Acceptance

There must be *offer and acceptance*, known as **mutual assent or meeting of the minds**. With an Offer made by one party (*Offeror*), clearly communicated to and accepted without any qualifications, or changes by a second party (*Offeree*).

Both of the parties clearly agree to the contract terms and the **offeror is notified of the acceptance**.



Valid & Enforceable Contracts



Proper Legal Form

The contract must be in **the proper legal form as stated by the state's statute of frauds**. In most states real estate contracts must be in writing to be enforceable.

Legal Act

Contract must be for a **legal purpose**. **Courts will not enforce an agreement or contract where the parties have agreed to do something illegal**. *The contract is void and as far as the courts are concerned the contract never existed.*

Legal Consideration

A promise made by one party to induce another party to enter into a contract.

A gift is good consideration while money or the promise to pay money is valuable consideration.

In a sales contract the buyer offering a purchase price and signing a buy/sell agreement is consideration.

Earnest money is not necessary to create a binding sales contract.

Reality of Consent

Reality of Consent occurs when a contract is **entered into without duress, misrepresentation, menace, or fraud and never occurs if it is**. If a party is not fully informed and willing to act the contract is voidable by the aggrieved party. Laws protect the party tricked or forced into a contract.

Signatures

If a state's statute of frauds is that a contract must be in writing to be valid, it must have the signatures of the parties authorized to perform. A buyer and seller must sign the buy/sell agreement and broker and seller the listing contract. **If the signatures are not there the contract is void, it never existed.**



CONTRACTS & OFFERS



Offer

To offer means to put forward an object or idea for acceptance, rejection, or consideration. It is the promise of one party to do or not do something in a specified manner provided the other party acts or performs in a manner requested. To start negotiations a proposal to purchase a property from a **Offeror** (buyer?) is given to the **Offeree** (seller?). Offers have an expiration time and date.

Counter Offer A new offer that is made in response to an offer received from an offeror.

Offer **Any change no matter how small** in a proposal to purchase by either party **creates a new offer**. NEW OFFEROR – NEW OFFEREE. The seller then becomes the offeror and the buyer the offeree. **A counteroffer has the effect of rejecting the original offer, which cannot be automatically accepted later unless revived by the offeror repeating it.**

Acceptance Contract is **accepted exactly as presented (*Meeting of the minds*)**. An agreement by parties to a contract to be bound by the terms of the offer.



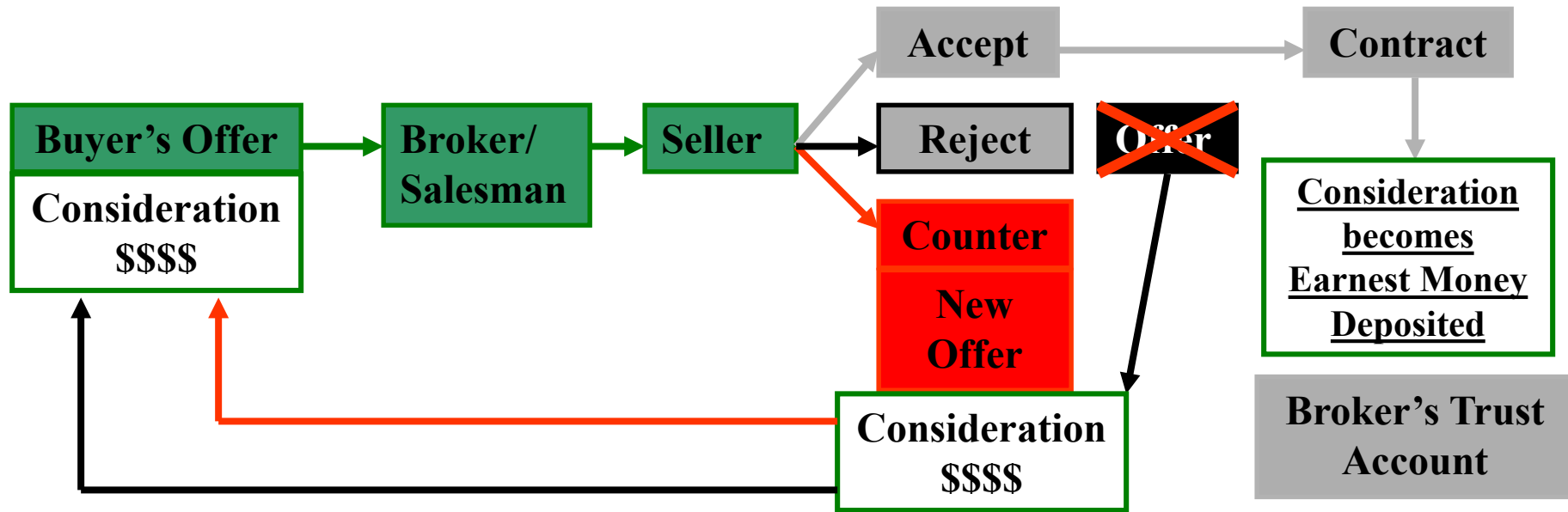
Acceptance is not complete until the offeror is notified.



Mailbox Theory

If an offer is made by mail, acceptance occurs and a binding or effective contract is created when the offeree places the accepted contract in the mailbox. Usually certified mail.

Contract Flow Chart



Listing Contract - Employment Agreement

A listing contract is considered to be an employment contract. If the seller is offered the full list price of the property and does not accept the offer, a commission is still due the broker because the broker was hired to secure a ready willing and able buyer.



RESIDENTIAL LISTING CONTRACT Exclusive Right to Sell



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Listing Agreements May Contain The Following Information:

1. Seller identification.
2. Listing Firm.
3. Length of Listing.
4. Price and Terms.
5. Property Legal Description
6. Personal property to be sold and what is to be kept by seller.
7. Condition and status of property (may refer to Property Disclosure Statement).
8. Statutory Disclosures required by state and federal governments.
9. Special Provisions
10. Real estate commission.
11. General Provisions.
12. Dated signatures of all parties.

BUY - SELL AGREEMENT

(Including Earnest Money Receipt)



Buy - Sell Agreements May Contain The Following Information:

1. Legal description of the property, buyer and seller identification.
2. Personal property to be sold and what is to be kept by seller.
3. Property purchase price and terms, i.e. Conventional loan, VA, FHA, etc.
4. Closing and possession dates i.e. possession on the date of recording the deed.
5. Earnest money receipt information.
6. Financing Conditions & Obligations including loan application date, etc.
7. Property inspections information and contingencies
8. Financing , appraisal, title and insurance contingencies
9. Additional provisions (covenants and conditions, additional pertinent information)
10. Type of deed (warranty, general warranty, special warranty) with any restrictions.
11. Water rights information.
12. Title insurance , condition of title, special improvement district contingency.
13. Proration of taxes and assessments information.
14. Declaration of the condition of the property.
15. Buyer's & Seller's contract remedies in case of a breach of contract by either party.
16. Sales agent relationship confirmation (buyer's agent or seller's agent).
17. Provision starting time period for acceptance.
18. Dated signatures of all parties.



Types Of Contracts



Bilateral Contracts

All parties are obligated to perform by exchanging promises (a promise for a promise). Examples; exclusive listings, buy/sell contracts, leases.

Unilateral Contracts

Only one party is obligated to perform. Examples: open listings and options where one party promises to sell but the other party pays for the right to purchase if they decide to do so.

Express Contracts

Parties agree specifically to do or not do something either in writing or orally

Implied Contracts

The parties create a contract by their actions or conduct. Examples: ordering food at a restaurant, buying gas, licensee getting personal information from a buyer

Executory Contract

One or more parties have a duty to perform the contract terms. Buy/Sell Contract, for example is executory as long as contingencies exist.

Executed Contract

All parties have fulfilled their contractual obligations and all contingencies have been removed. A Buy/Sell Contract is executed when the deed has transferred to buyer and the money given to seller.



Status Of Contracts



The status of a contract determines how the court will look at the contract.

Valid A valid contract has all legal elements (legally competent parties, offer & acceptance, proper legal form, legal consideration, reality of consent, signatures) – Contingencies have been removed and the contract is fully enforceable by the court.

Void The contract that has no legal force or binding effect. A void contract is no contract at all and never was. A contract with a racial restrictive covenant is void. A contract agreement to perform an illegal act is void.

Voidable The contract that appears valid and enforceable on its face but may be rescinded by one or both of the parties who acted under a disability. Disabilities include contracts entered into under duress, undue influence, misrepresentation, fraud, contracting with a minor (under 18) or someone who is incompetent. The aggrieved party can enforce the contract the other party cannot. A contract with a contingency that cannot be met is voidable

Unenforceable A contract that was valid when made but either cannot be proved or will not be enforced by a court. It had all legal elements but is only enforceable between parties. When neither party can sue the other for performance. A contract not performed within the statutory time period is unenforceable.

NOTE: If the parties agree to go ahead with a contract they can do so without being concerned with the courts even though performance dates have not been met or contingencies have not been removed.

Contracts Are Discharged By

Performance The terms of the contract are met and the contract is completed. This is based on the concept of “time is of the essence” where terms of the contract must be met based on the dates stated in the contract.

Assignment The transfer of rights, duties, title or interest in a property of one person (the assignor) to another (the assignee). These rights and duties can be transferred if they are not personal in nature. A listing is a personal contract and cannot be assigned for example. After an assignment the assignee is normally primarily liable and the assignor is secondarily liable for the contract. A buy – sell contract can be assigned with both parties agreement. A lease can be assigned with both landlord and tenant agreement.

Novation The substitution of a new obligation for an old one. Substitution of a new contract for an old one or substitution of a new party for the original party to the contract.

Breach Violation of any terms or conditions of a contract without legal excuse. A breach is a default or nonperformance. The party that did not breach the contract can usually seek one of three remedies. (1) recession of the contract (2) action for money damages (3) action for specific performance

Real Estate Terms



Important Terms Associated With Contracts

Time is of the essence

The clause in a contract that means the **contract must be performed within the time limit specified or within a reasonable time if no time is stated. The dates tied to the time limits are known as drop dead dates.** The party who does not perform on time may be liable for breach of contract and should a date pass without notification the contract may become void.

Ambiguities

ambiguities (confusion) in a contract are construed against the writer of the contract. If a buyer's agent wrote the contract and the court found that it was ambiguous the buyer may lose in court.

Contingency

Contract provisions that must be met before a contract is enforceable or binding. A contingency that cannot be met makes the contract voidable. Examples: the buyer must get the a loan; the seller must repair a broken window, etc.

Equitable Title



Exists in a sales contract, land contract, or trust deed. **It is the buyer's or lender's interest in the property. Both lender and buyer are considered to have an equitable title interest while the title is held by another party.** The courts will hear a lawsuit brought by the party not in legal title, they have legal standing.

Real Estate Terms (continued)



Important Terms Associated With Contracts

Liquidated Damages **Damages or compensation that will be paid if one party breaches the contract.** Earnest money deposited may be used as liquidated damages

in a sales contract. If the buyer breaches and seller takes the earnest money there is normally no other legal action the seller may take.

Right of first refusal



Has two meanings: (1) the right of a party to have the “*first right*” to purchase or lease a property, when and if the owner should decide to sell or lease. (2) It can be a contingency clause in a sales contract which allows the seller to continue marketing a property while contingencies are being removed. If another buyer makes an acceptable offer the original buyer must remove the contingencies or leave the original contract.

Suit for Specific Performance

A legal action to enforce the performance of the terms of a contract. The court’s position is that it has jurisdiction over a breach. This is based on the fact that land is unique and monetary damages are not adequate compensation to the buyer should the seller breach the contact. In some cases the seller can force the buyer to buy if property values have declined, but this is not normal. To do so the seller must show that that monetary damages would not be enough.

Real Estate Terms (continued)



Important Terms Associated With Contracts

Caveat Emptor Means “*Let the buyer beware*”. The historical legal concept was that the buyer should inspect the goods or real estate before they purchase because the buyer is buying the product “*as is*” and is at risk if there is something wrong.

Caveat Venditor

Means, “*Let the seller beware*”. The modern view has replaced the “caveat emptor” doctrine with one that the seller has a duty to inform the buyer of any items that might influence the buyer’s decision to purchase. This has expanded to include, “*Let the broker beware*”, where brokers and builders are required to inform purchasers, sellers or prospects of any and all material facts they have concerning the property.

Exculpatory Clause

A “**hold harmless**” clause, sometimes found in mortgages where the lender waives the right to a deficiency judgment. A clause in a lease that is intended to relieve the landlord from liability for tenant’s personal injury and property damage.



Indemnification Clause

A contract clause where **one party agrees to pay another for a loss or damage that happens**. In commercial real estate, for example, a buyer may require the seller to indemnify the buyer against claims caused by discovery of hazardous substances on the property.



Option Contracts

An option is a contract where the **Optionor** (seller) promises to sell the property to the **Optionee** (buyer) for a specific period of time should the buyer decide to buy known as exercising the option. At that point the option becomes a binding buy/sell contract.

The optionee gives the optionor something of value (money) for this right. Normally the sale price, date when the option ends, name and addresses of the parties, identification of the property, terms of sale, and disbursement of option money is included in the option. Unless the contract says otherwise, an option contract is assignable and is considered to be personal property. It is a unilateral, a one promise contract where the optionor promises to sell but the optionee does not promise to buy.

When it becomes a buy/sell agreement it becomes a bilateral contract, the seller promises to sell and buyer promises to buy.

Lease Option



The lessee (tenant) has the right to purchase the property under specified conditions or renew or extend the lease at its end. The rent or part of it may be applied to purchase.

Land Contract, Installment Land Contract, Contract For Deed

Vendor (seller) sells and finances the property but retains title until the final payment is made or some other condition is met by the vendee (buyer). Vendee

gives a down payment, monthly payments, pays the real estate taxes, and insurance. It is also known as a contract for deed, an installment contract, article of agreement for a warranty deed, bond for title or agreement of sale.