

SLIDE 1 – Real Estate Contracts (Cover Page)

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**Topics**

In this section we will cover the following topics:

- I. Contracts in General
- II. Essentials of a Contract
- III. Authority of Real Estate Licensees to Prepare Contracts
- IV. Classification of Contracts
- V. Contract Negotiation
- VI. Termination of Contracts
- VII. Contracts Important to Real Estate
- VIII. Miscellaneous Real Estate Contract Considerations

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**Learning Objectives**

Upon completion of this lesson, you should be able to:

- List and describe the essentials of a contract
- Distinguish among formal, parol, bilateral, unilateral, implied, expressed, executory and executed contracts
- Describe the various ways in which an offer is terminated
- Describe the various methods of terminating a contract
- Explain the remedies for breach of a contract

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- Describe the effect of the Statute of Frauds and the Statute of Limitations
- Describe the elements of an option
- Differentiate among the various types of listings
- Explain and describe the various disclosures required in a real estate contract
- Recognize what constitutes fraud
- Recognize what constitutes culpable negligence

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### Key Terms

Here are some key terms we'll encounter in this lesson:

- **assignment** – the method or manner by which a right or contract is transferred from one person to another
- **attorney-in-fact** – one who is authorized to perform certain acts for another under a power of attorney
- **bilateral contract** – a contract in which both parties have reciprocal obligations towards each other
- **competent** – having suitable or sufficient skill, knowledge, experience, etc., for some purpose; properly qualified

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- **contract** – an agreement between two or more competent persons to do or not do certain things in exchange for consideration
- **culpable negligence** – a charge that assigns criminal liability for gross acts of negligence that expose others to harm or the threat of harm
- **exclusive-agency listing** – a type of listing that requires the property owner to pay the broker a commission when the property is sold during the listing term by anyone other than the seller. If the seller finds the buyer, the broker is not entitled to a commission
- **exclusive-right-of-sale listing** – a type of listing that requires the property owner to pay the broker a commission if the property is sold during the listing term, no matter who sells the property

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- **fraud** – the misrepresentation of a material fact to someone who relies on the misrepresentation as the truth in deciding whether to enter into a contract
- **liquidated damages** – an amount that the parties agree in advance will serve as full compensation if one of them defaults
- **meeting of the minds** – When two parties to an agreement especially a contract understand the terms of the contract in the same manner, the parties are said to have 'meeting of the minds.' What one party understands should be exactly same as that understood by the other party. Meeting of minds is also called as mutual agreement, mutual assent or consensus ad idem. This is one of the essential elements in the formation of a contract

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- **net listing** – type of listing in which the commission is any amount received from the sale over and above the “net” required by the seller
- **novation** – when one party is completely replaced with another, or one contract is completely replaced with another, and all liability under the original contract ends
- **open listing** – a type of listing that requires the property owner to pay a broker’s commission only if the broker is the procuring cause of the sale
- **option contract** – a contract that gives one party the right to buy or lease the other party’s property at a set price for a certain period of time

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- **Statute of Frauds** – State law requires, among other things, that certain contracts relating to real estate must be in writing to be enforceable by law
- **Statute of Limitations** – Laws setting forth the period of time in which suit can be brought for a particular act
- **unenforceable** – when a contract cannot be enforced in a court of law because its contents cannot be proved, or it is voidable by the other party, or the statute of limitations has expired.
- **unilateral contract** – a contract whereby only one party is obligated to perform his obligation to another

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- **valid contract** – when a contract contains all of the required elements and is enforceable in court
- **void contract** – when a contract lacks an essential element, so that it has no legal force or effect
- **voidable contract** – when one of the parties can choose to rescind the contract, because of lack of capacity, fraud, etc.

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### Definition of a Contract

Real estate contracts are the legal agreements that underlie the transfer and financing of real estate, as well as the real estate brokerage business. Sale and lease contracts and option agreements are used to transfer real estate interests from one party to another. Mortgage contracts and promissory agreements are part of financing real estate.

Listing and representation contracts establish client relationships and provide for compensation.

In order to work with real estate contracts, it is imperative first to grasp basic concepts that apply to all contracts in general. These concepts provide a foundation for understanding the specifics of particular types of real estate contract.

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### **Contract Preparation**

State laws define the extent to which real estate brokers and agents may legally prepare real estate contracts. Such laws, referred to as "broker-lawyer accords," also define what types of contracts brokers and agents may prepare.

In some states, brokers and agents may not draft contracts, but they may use standard promulgated forms and complete the blanks in the form.

As a rule, a broker or agent who completes real estate contracts is engaging in the unauthorized practice of law unless the broker is a party to the agreement, such as in a listing agreement or sales contract. Brokers and agents may not complete leases, mortgages, contracts for deed, or promissory notes to which they are not a party.

Agents must be fully aware of what they are legally allowed to do and not do in preparing and interpreting contracts for clients. In addition to practicing law without a license, agents expose themselves to lawsuits from clients who relied on a contract as being legally acceptable.

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### **Statute of Frauds**

The statute of frauds requires that certain contracts *must be in writing* to be enforceable. Real estate contracts that convey an interest in real property fall in this category, with the exception that a lease of one year's duration or less may be oral. All other contracts to buy, sell, exchange, or lease interests in real property must be in writing to be enforceable.

In addition, *listing agreements* in most states must be in writing.

The statute of frauds concerns the enforceability of a contract, not its validity. Once the parties to a valid oral contract have executed and performed it, even if the contract was unenforceable, a party cannot use the Statute of Frauds to rescind the contract.

For example, a broker and a seller have an oral agreement. Following the terms of the agreement, the broker finds a buyer, and the seller pays the commission. They have now executed the contract, and the seller cannot later force the broker to return the commission based on the statute of frauds.

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### **Statute of Limitations**

The statute of limitations restricts the time period for which an injured party in a contract has the right to rescind or disaffirm the contract. A party to a voidable contract must act within the statutory period.

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### **Legal status of contracts**

In terms of validity and enforceability, a court may construe the legal status of a contract in one of four ways:

- Valid
- Valid but unenforceable
- Void
- Voidable

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### **Legal status of contracts**

**Valid** – A valid contract is one which meets the legal requirements for validity. These requirements are explained in the next section.

A valid contract that is in writing is enforceable within a statutory time period. A valid contract that is made orally is also generally enforceable within a statutory period, with the exceptions noted below.

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### **Legal status of contracts**

**Valid but unenforceable** – State laws declare that some contracts are enforceable only if they are in writing. These laws apply in particular to the transfer of interests in real estate. Thus, while an oral contract may meet the tests for validity, if it falls under the laws requiring a written contract, the parties will not have legal recourse to enforce performance.

An oral long-term lease and an oral real estate sales contract are examples of contracts that may be valid but not enforceable.

Note that such contracts, if valid, remain so even though not enforceable. This means that if the parties fully execute and perform the contract, the outcome may not be altered.

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### **Legal status of contracts**

**Void** – A void contract is an agreement that does not meet the tests for validity, and therefore is no contract at all. If a contract is void, neither party can enforce it.

For example, a contract that does not include consideration is void. Likewise, a contract to extort money from a business is void. Void contracts and instruments are also described as "null and void."

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### **Legal status of contracts**

**Voidable** – A voidable contract is one which initially appears to be valid, but is subject to rescission by a party to the contract who is deemed to have acted under some kind of disability. Only the party who claims the disability may rescind the legal effect of the contract.

For example, a party who was the victim of duress, coercion, or fraud in creation of a contract, and can prove it, may disaffirm the contract. However, the disaffirmation must occur within a legal time frame for the act of rescission to be valid. Similarly, if the party who has cause to disaffirm the contract elects instead to perform it, the contract is no longer voidable but valid.

A voidable contract differs from a void contract in that the latter does not require an act of disaffirmation to render it unenforceable.