

An \* in the left margin indicates a change in the statute, rule or text since the last publication of the manual.

## CHAPTER 14 – CONTRACTS

### General

Together with the laws of agency and brokerage relationships, an understanding of contract law is essential for the real estate practitioner. A licensee constantly reviews contracts of purchase, lease agreements and mortgages. In Colorado, real estate licensees are allowed to fill in blanks in standard contract forms. The competency and professionalism of the real estate licensee are always at stake when contracts are being written or explained.

Of all legal instruments, contracts are one of the most important to our society and economic system. The stability and security of our business world are dependent upon the law of contracts. It insures the performance of the parties to their agreements by requiring that they either perform or pay for all loss or damage caused by non-performance. Furthermore, the specialized branches of business law, such as the sale of goods and services, negotiable instruments, partnerships and corporations, are all founded upon the law of contracts.

A contract may be defined as an agreement between two or more competent persons, having for its purpose a legal object, wherein the parties agree to act in a certain manner.

### Essential Elements Of A Contract

To be binding and enforceable at law, all contracts must have four essential elements: (1) mutual assent, (2) consideration, (3) competent parties, and (4) legal purpose.

1. **Mutual Assent.** Before a valid contract can exist, the parties must mutually consent to be bound by the terms of the agreement. Such mutual assent is evidenced or objectively set forth by the offer and acceptance. If the consent was obtained by fraud, misrepresentation, duress, undue influence, or mistake, then there is no real consent and, therefore, the element of mutual assent is absent. In certain cases the law requires that the expression of the parties' mutual agreement must be in writing to be enforceable.

- a. **Offer.** An offer is a promise by one party to act in a certain manner provided the other party will act in the manner requested. The one making the offer is called the offeror; the one to whom the offer is made is called the offeree.

If a person says, "I'll give you \$20 for that tire," that person is making an offer. They are saying, essentially, "I promise to pay you \$20 if you will deliver to me the ownership and possession of the tire." Similarly, when a prospective buyer of real estate signs a "contract" to purchase property, they are making an offer to the seller to buy the property on stated terms and conditions. No contract exists until the seller agrees.

To be effective, an offer first must be communicated to the offeree by a means selected by the offeror. Secondly, the offer must be intended as such. Whether it is intended as an offer depends, not on the offeror's subjective mental attitude, but on the reasonable interpretation given to the communication by the offeree.

Expressions made in jest, anger, or excitement are generally not offers because the hearer should realize that the speaker is not, at the moment, seriously contemplating what is said. Thirdly, an offer to be effective must be definite and certain as to its terms. If the offer is indefinite as to some of its terms, no mutual agreement can occur because reasonable persons could disagree as to the interpretation of the indefinite provisions. How long does an offer last? When does it cease? An offer can be terminated by a lapse of time, by revocation, by rejection or by operation of law.

- (i) **Lapse of time.** The offer may specify the length of time it is to remain in effect. Upon expiration of that time, the offer ends. However, an expired offer may become effective if ratified. Ratification occurs if a person's acts or conduct validate an otherwise unenforceable act. For example, if a buyer gives a seller three days to accept the buyer's offer to purchase property and the seller accepts the offer on the fifth day, the offer would normally be considered dead because of lapse of time. However, if the buyer remained silent, allowed the contract to go to closing and then backed out because the offer was accepted late, the buyer may be said to have ratified the contract through their conduct. If no time is specified, then the offer terminates upon the expiration of a reasonable length of time. Reasonable time is determined by all the surrounding circumstances; for instance, it is less in the case of an offer to sell perishable goods than for nonperishable goods.
  - (ii) **Revocation.** The offeror may revoke, cancel, or withdraw an offer at any time before acceptance, even if he or she may have stated the offer would be held open for a certain period. Thus a person may offer to sell or buy a vacant lot, telling the other party that they have ten days in which to accept. Two days later, if the other party has not accepted, the offeror may cancel without liability. But when an option exists, an offeror cannot withdraw their offer without liability. An option is a subsidiary contract to hold open an offer for a stated period of time. Many so-called options are not enforceable because consideration (something of legal value) has not been given in return for the option. In the above example, if the second party had paid or promised to pay five hundred dollars for the privilege of having ten days in which to decide, then there would be an option and the offeror could not withdraw the offer during that time.
  - (iii) **Rejection.** An offer is terminated by rejection or refusal of the offeree. If the offeree agrees to accept the offeror's proposal but on different terms, this is called a counter offer and constitutes a rejection of the original offer.
  - (iv) **Operation of law.** Offers can be terminated automatically by operation of law. Generally, the death or insanity of either the offeror or offeree ends the offer. Destruction of the subject matter of the offer or a change of law making the object of the offer illegal will also terminate the offer.
- b. **Acceptance.** The second step in achieving mutual assent is the acceptance, i.e., the indication by the offeree that they are willing to be bound by the terms of the offer. In a real estate transaction, this is usually accomplished by the seller signing the offer to purchase made by the buyer.

To be effective, an acceptance must be made and communicated according to the manner, time, place and terms specified in the offer. If not specified, then the acceptance must be made and communicated in a reasonable manner, according to the custom and usage of the trade in that locality.

- c. **Reality of Consent.** For mutual assent to exist, consent must be given knowingly and voluntarily. If a party consents due to fraud, misrepresentation, undue influence, duress or mistake, it would be unfair to hold them to the agreement. Therefore, when consent is obtained under these circumstances, the courts usually hold that there is no contract, or permit the innocent party to cancel the contract.

When there is a mutual mistake as to material fact concerning the identity or existence of the subject matter, no contract results. But when the mistake concerns an unessential fact, or relates to the value, or is made by only one party due to that party's carelessness, an enforceable contract will result. Thus, if the parties agree to buy and sell property at a certain address and there are two properties having the same address, and each party has in mind a different property, no contract results. But if one party has a mistaken belief as to the value of a piece of property, a good contract will result.

Fraud and misrepresentation are self-explanatory and, when present, permit the innocent party to cancel the contract and, in appropriate cases, to recover damages suffered.

Undue influence consists of the abuse of the control or influence that one person has over another because of their relationship. Duress consists of compelling a person, through fear, to do or to agree to do an act.

- d. **Statute of Frauds.** To prevent fraud through perjury, the law requires that the parties' agreement evidencing their mutual assent must be in writing in certain cases. As to real estate, the Colorado law provides:

"Every contract for the leasing for a longer period than one year, or for the sale of any lands or any interest in lands, is void, unless the contract, or some note or memorandum thereof, expressing the consideration is in writing, and subscribed by the party by whom the lease or sale is to be made." (C.R.S. 38-10-108)

In Colorado real estate contracts not signed by the seller are void, not voidable. Colorado differs from most other states that provide that "the party to be charged" (in a lawsuit by the other party) must have signed the contract.

Other agreements that are declared void by law are (C.R.S. 38-10-112):

- (i) Every agreement that by the terms is not to be performed within one year from the making thereof;
- (ii) Every special promise to answer for the debt, default, or miscarriage of another person;
- (iii) Every agreement, promise, or undertaking made upon consideration of marriage, except mutual promises to marry.

Generally, the statute of frauds provides that no civil action can be brought to enforce a contract unless there is some writing signed by the party to be charged (in civil action to enforce the contract). The writing does not have to be the "perfect"

contract but it does have to be sufficient to allow a court to determine that the parties intended to sell the property. Such things as (1) the identity of the parties, (2) subject matter, (3) terms and conditions, (4) recital of consideration and (5) signatures of the parties are necessary. Although Colorado's statute of frauds only provides that the seller must sign the real estate contract, the obvious best practice is for both parties to sign.

Some states have statutes of fraud provisions in their real estate license laws. These laws provide that a real estate licensee shall not be entitled to a commission unless there is a written employment agreement between the licensee and the buyer or seller. Although the Colorado license law does not have such a statute of frauds provision, there is a statutory requirement that all agency listings and agency employment agreements be in writing.

- e. **The Parol Evidence Rule.** The parol evidence rule is closely linked to the statute of frauds. It provides that an agreement in writing shows that the parties intend it as the final and complete expression of their agreement. Evidence of any earlier oral or written statements is not admissible to vary, add to or contradict the terms of the writing. The word parol means "word" or "speech". Since the purpose of the statute of frauds is to prevent the possibility of nonexistent agreements being enforced by fraud or perjury, it makes sense to have a rule that requires the parties to live with what they have written. The parol evidence rule generally keeps parties from trying to introduce evidence in court that they really meant something other than what is stated in the contract.

- 2. **Consideration.** Agreement alone does not make an enforceable contract. There must be consideration supporting the agreement. Many persons assume money is a requirement of consideration; but in the vast majority of cases the consideration for a promise is the return promise. The promise of the buyer to buy and the promise of the owner to sell constitute sufficient consideration to support their agreement - no deposit is necessary.

Consideration may be defined as a promise or an act of legal value bargained for and received in return for a promise. Both parties must receive consideration for their promises. Legal value is generally defined in terms of benefit or detriment. Thus legal value is present if (1) the one making the promise (or doing the act) thereby commits to something they were not previously obligated to do (detriment), and (2) the one receiving the promise (or act) thereby becomes entitled to something they would not previously have received (benefit). Both parties to an agreement usually receive some benefit and suffer some detriment.

When one party agrees to buy and another agrees to sell, each is agreeing to do something they were not obligated to do and each will receive something to which they were not entitled. But offering to pay a police officer \$1,000 as a reward for recovering stolen property cannot be consideration for that offer. In promising to recover stolen property, a police officer is doing no more than already bound to do. A promise given without any return does not create a binding contract. Each party must in some way give legal value for what they receive.

Although the promise to pay for land, if written in the contract, is good consideration, the buyer customarily shows good faith by making a partial payment on the purchase price. This partial payment is called "earnest money" or "good faith money". It is a good

indication that the buyer will perform as promised and pay for the land because if they do not they will lose the money according to the default provision of the contract.

3. **Competent Parties.** All parties are presumed to have the legal capacity to enter into contracts. But certain persons, for reasons of public policy or some disability, do not have full contractual capacity. Among these are minors, mental defectives, and intoxicated persons.

In Colorado, a minor is one who is under eighteen years of age. Minors have the right to cancel or disaffirm their contracts with no liability other than the return of any proceeds they received under such contract. The minor is given this right to protect them against their lack of experience, judgment and ability. The burden is upon the adult to ascertain that the person they deal with is of legal age. After reaching legal age, a minor may ratify or approve a previous contract and they will then be bound thereby.

Insane persons are given the same protection as that given to minors, except that the contracts of a person judicially declared insane could never have had effect in the first place.

The contract of an intoxicated person is usually binding, except where that person is so intoxicated as to be incapable of understanding the nature of the transaction. In that case, the intoxicated person may cancel or ratify the contract.

A corporation's charter determines its contractual ability. Its capacity to contract may be related only to specific things or it may be related to broad areas of business transactions.

4. **Legal Purpose.** To be valid and enforceable a contract must have a legal object for its purpose. The object cannot be to violate valid statute. An agreement to commit a crime, a tort, or something contrary to public welfare is illegal. For example, an agreement to defraud someone, or to slander a person, or to operate an unauthorized gambling operation is illegal. Dual contracting to induce a lender to make a loan on real estate without knowing the true terms of sale, such as the actual amount of down payment, is a criminal offense under C.R.S. 18-5-208.

### **Matters To Be Considered In Real Estate Contracts**

The buy-sell contract is the most important document in a real estate transaction. The contract determines the kind of title to be conveyed, the type of deed, liens and encumbrances that the land will be sold subject to, and the manner of payment of the purchase price.

Numerous controversies involving real estate licensees arise out of contracts for the sale of property. Although dishonesty or wrongdoing on the part of the licensee is rare, disputes stem from the licensee's lack of thoroughness or knowledge. Real estate brokers must continually strive to increase their own proficiency and that of their employed licensees in writing good contracts. It is a real art to write a sound, workable contract that includes all important matters and is still reasonably clear and understandable. Although Colorado licensees are fortunate in having commission-approved contract forms available, they must nevertheless pay close attention to completing these forms in a competent manner.

The following are the main items to be considered in drawing up real estate contracts. This list is not intended to be exhaustive; seldom are two real estate transactions alike. Only through careful study, experience and guidance will the real estate licensee learn to recognize the essential items to be included in a given transaction.

1. **Names and Signatures of the Parties.** The seller and buyer must be named and properly designated as to which is the seller (vendor) and buyer (vendee). If two

or more persons own the property, all should be named and all should sign - unless, of course, only one is selling his or her interest. If two or more persons are buying the property, all should be named and should sign, together with an election as to whether they are buying as joint tenants or tenants in common.

2. **Sale Price and Payment Provisions.** The contract is incomplete and unenforceable unless it contains the sales price. If there is no provision as to the method of payment, the law presumes it is to be a cash sale. The contract should state, when applicable, the amount of the deposit; the amount to be paid at closing; the method of payment; the balance either by assumption of the existing mortgage or by a new mortgage; and any and all other pertinent financial provisions.
3. **Description of the Property.** The description of the real estate should be sufficiently definite to identify the land sold with reasonable certainty. Although the street address, with the city and state, is sometimes sufficient, it is better to use the legal description contained in the seller's deed. Even though the contract may not mention them, such additional rights to the land as easements, rights of way, and other appurtenances belonging to the land, will automatically pass to the buyer in the transfer of ownership. For the sake of clarity and completeness, they should be mentioned in the contract. In addition, all items of personal property to be included in the sale should be listed.
4. **Type of Deed.** The contract should provide for the type of deed by which the property will be conveyed, whether by quitclaim, general warranty, or other kind of deed. In the event the type of deed is not stated, the courts will probably require that kind of deed that is customary to that particular type of transaction in that locality.
5. **Condition of Title.** Real estate sales contracts traditionally provide that title is to be merchantable, that is, free from defects and which a reasonably prudent buyer is willing to accept. Even without this provision, the law presumes that merchantable title is to be conveyed. Mortgages, tax liens, and other liens and encumbrances are considered defects. Therefore, if the property is to be conveyed subject to a mortgage or other encumbrance or restriction, the contract should clearly state so. Another customary provision states that the buyer will give written notice of defects of title, not excepted in the contract, and that the seller will clear up said defects by a given deadline. The seller has the duty of proving good title. A contract should require the owner to establish their title by furnishing evidence of ownership, such as an abstract of title or a title insurance commitment. In approved Colorado buy-sell contract forms, the seller does not specifically agree to provide merchantable title. However, the seller does agree to provide the buyer with a title insurance commitment, and, if the buyer objects to the merchantability of title, the seller must correct unsatisfactory title conditions or the contract shall terminate.
6. **Default Provisions.** The rights of the parties should be stated in the event that one side fails to perform. The law, of course, gives the parties remedies for non-performance, but a lawsuit can be avoided if the parties mutually agree to a settlement beforehand. Therefore, provision should be made as to the disposition of the buyer's deposit if the buyer should default, and any other arrangements deemed appropriate. It is especially critical for brokers to counsel buyers on the meaning and effect of the loan commitment deadline in the commission-approved buy/sell contract. 100% commitment to fund a loan seldom exists, but buyers must have a sufficient level

of understanding and comfort with their own and their lender's commitment as of that date, or face certain forfeiture of earnest money if the transaction does not close.

7. **Contingency Provisions.** A buyer may be willing to buy, but may first have to accomplish something, such as borrow additional money or sell a presently owned property. An offer to purchase must clearly state such conditions. It is possible that the seller may also wish to provide for some contingency. Poorly written contingencies are one of the major causes of disputes between the parties and complaints against real estate licensees. Any contingency clause must state not only the conditional situation or event, but also provide a definite method and deadline by which to accomplish the contingent requirement, remove the contingency or terminate the contract, including disposition of earnest money.
8. **Possession.** If the time of closing the transaction is different from the time that possession of the premises is to be given to the buyer, the date and time of possession should be stated.
9. **Apportionment or Adjustment.** The contract should provide for the apportionment of all charges or assets concerning the property - such as, taxes, assessments, water rents, interest on assumed encumbrances, mortgage insurance premiums or rents.
10. **Risk of Loss.** If the property is damaged or destroyed by fire, flood or storm after the contract is signed but before the deed is delivered, who suffers the loss - the seller or the buyer? The answer is not as simple as it seems.

In most jurisdictions, when a binding real estate contract exists, and where either party may enforce specific performance, the loss falls upon the buyer who is considered the owner of the property. The buyer holds what is known as equitable title even though legal title has not yet passed. The buyer can legally force the seller to convey the legal title. Also, the seller can force the buyer to accept the legal title and perform their part. This right is called specific performance; the parties lose the right only if they waive it in the contract.

Some courts interpret equitable title theory as unjustly putting the burden of loss on the buyer. Not being in possession, the buyer is unable to protect his or her interest. However, the majority of courts seem to hold that the loss falls on the buyer unless the contract provides otherwise. To avoid potential misunderstanding or controversy, it is important to clearly spell out risk in the contract. It is not unusual for the contract of sale to provide that the risk of loss remains with the seller.

### **Colorado Buy-Sell Contracts**

Buy-sell contracts used by licensees are sometimes referred to as "preliminary", "earnest money" or "executory" contracts. They contain, among other provisions, a promise by the buyer to pay for the land and a promise by the seller to deliver a deed to the land. These contracts serve the purpose of establishing good faith until the time for payment and delivery of the deed. Buy-sell contracts are not recorded (except for very good reason) because many such contracts fail and are never consummated. Recording would cloud the title to the land if delivery of a deed did not occur. However, an installment land contract, described later in this chapter, should always be recorded unless there is a specific agreement to the contrary.

There are several types of buy-sell contracts approved by the Real Estate Commission and used by Colorado licensees. These include the residential, commercial and vacant

land/farm and ranch contracts to buy and sell real estate. The default provisions for each contract are shown below. Note the different remedies afforded.

### **Contract To Buy And Sell Real Estate**

**"TIME OF ESSENCE, DEFAULT AND REMEDIES.** Time is of the essence hereof. If any note or check received as earnest money hereunder or any other payment due hereunder is not paid, honored or tendered when due, or if any other obligation hereunder is not performed or waived as herein provided, there shall be the following remedies:

**a. If Buyer is in Default:**

**(1) Specific Performance.** Seller may elect to treat this contract as canceled, in which case all payments and things of value received hereunder shall be forfeited and retained on behalf of Seller and Seller may recover such damages as may be proper, or Seller may elect to treat this contract as being in full force and effect and Seller shall have the right to specific performance or damages, or both.

**(2) Liquidated Damages.** All payments and things of value received hereunder shall be forfeited by Buyer and retained on behalf of Seller and both parties shall thereafter be released from all obligations hereunder. It is agreed that such payments and things of value are LIQUIDATED DAMAGES and (except as provided in subsection c) are the SELLER'S SOLE AND ONLY REMEDY for Buyer's failure to perform the obligations of this contract. Seller expressly waives the remedies of specific performance and additional damages.

**b. If Seller is in Default:** Buyer may elect to treat this contract as canceled, in which case all payments and things of value received hereunder shall be returned and Buyer may recover such damages as may be proper, or Buyer may elect to treat this contract as being in full force and effect and Buyer shall have the right to specific performance or damages, or both.

**c. Costs And Expenses:** In the event of any arbitration or litigation relating to this contract, the arbitrator or court shall award to the prevailing party all reasonable costs and expenses, including attorney and legal fees."

The broker is in a position to strongly influence the choice of remedy. This position of influence should be used guardedly because there are circumstances when the use of a particular remedy may be injurious to one of the parties.

The liquidated damages provision is popular for various reasons. In the event of default by the buyer, the usual seller does not want to become involved in a lawsuit against the buyer in order to enforce the specific performance of the contract. The seller is usually more concerned about getting the property back on the market and making a successful sale. The broker has the same desire. The average buyer is not often engaged in a real estate transaction and is not aware of the possibility that they might be compelled to purchase the property. The knowledge of such a buyer usually extends no further than knowing that the earnest money is endangered.

The specific performance and damages remedy is appropriate, particularly if the buyer and seller are experienced in real estate dealings. It may be the fairest because it offers both parties an equal right to seek damages.

Earnest money deposits are another critical element of any contract. Earnest money should be adequate to demonstrate the buyer's serious intent to purchase and, in the event of the buyer's default, to compensate the seller for the act of taking the property off the market during



the period prior to closing. Earnest money should apply only to part payment of the purchase price. The form of earnest money, e.g. check or promissory note, must be specified in the contract. If a note, it must have a definite due date. The Commission strongly recommends that notes not be taken with due date "at closing". Such notes create confusion as to the seller's forfeiture rights if closing does not occur and the buyer is at fault.

The Commission-approved buy-sell contracts include a mediation clause by which the parties agree to submit matters in dispute to mediation when the dispute cannot be otherwise resolved. Mediation is non-binding. If efforts at mediation do not resolve the dispute within 30 days of the written notice requesting mediation, the mediation terminates unless the parties mutually agree to continue.

If mediation fails to resolve an earnest money dispute the approved contract forms provide that an "interpleader" action is appropriate. Under this provision, if the parties do not give mutual written instructions to the broker, the broker may "interplead" the money into court and let the court decide the matter. Although the broker may interplead without such a provision, the existence of the provision encourages the parties to make settlement. The provision also enables the court to relieve the broker from court costs and attorney's fees. Nothing, of course, prohibits a broker from refunding an earnest money deposit to a buyer if, in the broker's judgment, that is what the contract calls for, but the broker may subsequently become liable to the seller if the disbursement is found to be wrongful. A broker may never unilaterally declare a forfeiture of the buyer's earnest money. Only the seller may declare a forfeiture.

### **Competency In Preparing Contracts**

The terms in any agreement to buy and sell real estate must be carefully drafted. Contingencies and promises must be completely defined. Consideration of the circumstances affecting the parties involved in the transaction must be carefully weighed before spelling out the terms.

1. **Loan Contingency.** The ordinary buyer can only buy if able to borrow sufficient funds on reasonable terms. Ethical procedure demands that the contract be made contingent upon the ability to secure such a loan. If a buyer is unable to buy unless the sale of their current home is consummated, any offer should reflect this contingency. Such a contingency is still needed even if there is a pending contract to sell the buyer's home, if the buyer needs the proceeds from the sale in order to purchase, because there is never complete certainty that a pending sale transaction will close.
2. **Assumptions.** When an existing mortgage will remain on the property after sale, the responsibility of the parties must be carefully set forth. The buyer may "assume and agree to pay" the existing mortgage or may buy the property "subject to" the existing mortgage. A seller will usually want the buyer to "assume and agree to pay" because it will make the buyer responsible on the original note along with the seller. In either case, both parties to the transaction should be informed of the resultant effect of the sale. Too often unscrupulous buyers of equities have purchased "subject to" or even agreed to "assume and pay" an existing loan. They then collect rents from the property for as long as possible, while deliberately defaulting on the loan payments and letting the property go into foreclosure. A resulting deficiency judgment would be against the original owner and seller rather than the buyer. Such conduct, known as "equity skimming", is a criminal offense.

It is equally important that the broker assure that, if necessary, a buyer is properly qualified to assume a loan and that the assumption is properly processed through the lender. Licensees are subject to disciplinary action for failing to ensure that loan assumptions are finalized through the lending institution.

- 3. Buyer's Creditworthiness.** The licensee's service to the seller (for which they are paid) is to procure a ready, willing, and able buyer. What is meant by "able"? Certainly it means more than the buyer's ability to execute the contract and make the initial payment. The licensee has a duty to the seller to make a reasonable effort to determine if the buyer is truly able to buy. If the buyer is assuming an existing loan, or if the seller is carrying back a purchase money mortgage or conveying by means of an installment land contract, the seller is in a high risk position. There is no third-party lending institution to determine the buyer's qualifications. The typical residential seller is not a speculator, and does not wish to pursue foreclosure or to retake title to the sold property. The seller will likely depend upon the licensee for guidance. Although the licensee may have no legal obligations to investigate the buyer, the licensee at least has a duty to inform the seller of the inherent dangers in the transaction and to advise the seller to make some type of an investigation concerning the buyer's ability or willingness to pay.

A buyer may wish to use the seller's credit by having the seller secure a new loan or refinance the existing loan so that the buyer can purchase with less cash or no cash and without responsibility. The seller might also be induced to carry a second purchase money mortgage, which may even result in cash being given to the buyer at the time of closing. Thus, the buyer purchases without a down payment. This type of transaction may be perfectly proper if the seller knows the buyer or has faith in the buyer's creditworthiness. However, the seller is in an extremely vulnerable position and the broker should alert the seller to this fact.

- 4. Balloon Payments.** If a buyer agrees to sign a second note and trust deed as part payment, the terms should be specifically set forth. If a note requires regular equal installments but will not be completely paid off at the time the note matures, a larger (balloon) payment will be required at the maturity date. The buyer may be in danger of foreclosure if unable to raise the money for such a "balloon payment". In such a case, the licensee should make the buyer and seller aware of this eventuality. At the time the balloon payment becomes due the buyer may be dependent on the ability to refinance. Colorado law protects the borrower in this regard. (See the Uniform Consumer Credit Code printed in this Manual.)

**Surveys.** Many properties have not been properly surveyed. This is true particularly in areas that have not been formally subdivided into platted parcels. Some subdivided areas also contain irregular lot sizes and the survey may be questionable. Both the frontage in running feet and the acreage, which determines square footage, are important and both should be verified before quoting figures to a buyer. In some cases improvements, such as fences or garages, encroach on boundary lines and only a survey will reveal the problem. A broker may be liable in such situations because brokers are assumed to have greater knowledge than that of buyers and sellers. The broker should recommend to both buyer and seller that a survey be made. (See Chapter 7)

**Dual Contracting and Loan Fraud.** Another matter covered by law involves presenting a false contract with a larger purchase price to the lender than the price shown on the contract under which the parties intend to consummate the transaction. This is

called dual contracting to induce a loan and is prohibited by the Colorado Criminal Code, C.R.S. 18-5-208.

False or inflated down payments, failure to identify seller-assisted down payments or concessions, second trust deeds, "gift letters" or any other matter not fully and accurately reflected in a buy-sell contract and resulting settlement statement may result in severe disciplinary and sometimes even criminal action against a licensee.

### **Installment Contracts**

The installment land (ILC) contract is described in the chapter on trust deeds and liens and the chapter on financing as a method of financing or a security device. However, it is also a method of effecting a sale. From the broker's viewpoint, it is a sale entitling legal claim to an earned commission.

An ILC is a contract for delayed delivery of a deed providing for periodic payments over a term of years, as does a promissory note. It is distinguished from the real estate buy-sell contract in that the buy-sell does not usually contain provisions for installment payments and are merely intended to hold the deal for a short period until the condition of title is accepted and title is delivered to the buyer.

A buy-sell contract may also be used to hold a deal until the execution of an installment land contract. In this case, the buy-sell agreement will of course not refer to delivery of a deed but rather to the subsequent signing of an installment land contract.

If a buy-sell contract is of the specific performance type, it has the same effect as an ILC in that the seller is bound to convey the land to the buyer at some future time. At the signing of either type of contract, the buyer has an equitable interest in the real estate. Courts generalize this result and say that the "buyer becomes owner of the land in equity" and is called the "equitable owner".

Installment land contracts are more prevalent during periods of "tight" money or when a property is difficult to finance conventionally. Oftentimes a person with little or no cash for a down payment will be permitted to take possession of property under an installment land contract providing for monthly payments to the seller. The seller will still hold "legal" title, and the buyer possesses "equitable" title.

A preliminary contract for an ILC will not usually be recorded unless a dispute arises and court action is imminent. It will always be in the buyer's best interest to have the installment land contract recorded, and the real estate commission requires that buyers of subdivisions registered with the commission be so advised. Sellers of unimproved subdivided lands have often used installment land contracts. If an ILC is not recorded, there is no notice to the world of the buyer's interest in the property, the buyer being completely at the mercy of the seller. The larger the buyer's down payment offer to the seller, the stronger the buyer's bargaining strength as to deed and trust deed arrangement.

Although the seller retains legal title under an installment land contract, he or she is not the actual owner of real estate. The seller's interest in the contract is considered personalty, and would be treated as such in the distribution of the estate in the event of the seller's death. The seller would convey legal title interest in the property by formally assigning the contract. Any person buying a seller's legal title interest should make sure that the contract being assigned is of public record, and should receive the original signed ILC in the assignment. If a seller merely has a contract interest and is not the holder of legal title, the contract or assignment should so state.

The buyer's interest in an installment land contract is considered realty and generally is merchantable to a third person. If an ILC has a non-assignment clause, the seller's consent must be secured. Often times the contract will preclude the property from being mortgaged or leased. Of course the buyer under an ILC could not give a trust deed even if the contract permitted, because the buyer does not have a deed. A buyer's interest given as collateral for a loan would be secured by a mortgage. The phraseology of an assignment or new contract will determine whether the assignee is personally liable to make the remaining payments.

If there is an existing loan on the property the installment land contract should state who is to make the payments. It is not enough to merely state that the property is subject to an existing loan. Such a statement would make the buyer responsible for both the contract price and for the seller's existing loan payments in order to protect equitable title interest. Usually it is the seller who continues to make the payments on the existing loan and the contract should so state. It should also provide that in the event the seller fails to make payments, that the buyer is permitted to pay the lender directly, and credit the amount paid against payments owed to the seller under the ILC.

An installment land contract usually provides that a deed to the property will be delivered when the full purchase price or a specified portion (e.g.  $\frac{1}{3}$  or  $\frac{1}{2}$ ) has been paid. This may create a problem if the seller is not able to execute and deliver the deed when it is due. A high level of trust is placed in the seller's being able to convey a future deed clear of all encumbrances. If the seller dies before the buyer fulfills the contract, other difficulties may arise. The seller's interest may be tied up in estate proceedings. Therefore, if the seller is a natural person rather than a corporation, it is prudent to place the deed with an escrow agent at the time of sale, with proper instructions to deliver when the buyer has complied with the contract. If a deed is being held in escrow and the seller assigns the contract, a new agreement with the original escrow agent is necessary to substantiate the chain of title to the property.

There is usually nothing to prevent the buyer from refinancing an installment land contract at any time and paying off the seller. As with any loan, however, terms or restrictions on prepayment should be clearly set out in the contract.

In the event of a default in payments under an ILC, the seller is limited in their remedies by a forfeiture clause in the contract. The usual forfeiture clause gives the seller the choice of foreclosure or suing for payments when each comes due. Upon choosing one remedy, the other is lost. Thus, upon default, the seller usually keeps the money that has already been collected and forecloses to secure the return of the property.

A forfeiture clause usually demands that possession of the property be surrendered to the seller within 30 days or so after default. Even if in possession, however, the seller must still go to district court to foreclose. This would amount to strict foreclosure if the courts enforced the foreclosure clause. In mortgages or trust deeds the courts will not enforce strict foreclosure, but in an installment land contract the courts may do so, if only partially, inasmuch as there is no public sale. A seller who chooses this remedy elects to rescind the contract and cannot get a deficiency judgment. The court, in its judgment, will often determine how long the buyer may keep possession regardless of how many days are stated in the forfeiture provision. In one Colorado case, when the buyer had paid approximately one-third of the purchase price, the court required that the buyer be given six months to redeem.

Some sellers or their brokers attempt to avoid having to go to court to foreclose the contract. One popular but ineffective method of doing this is to have the buyer sign a quitclaim deed back to the seller up front, and escrow both the ILC and the quitclaim deed. The escrow agreement would provide for delivery of both the buyer's copy of the ILC and the quitclaim deed to the seller in the event of default. Adding the quitclaim deed to the escrow does not in any manner strengthen the position of the seller since it would have been executed simultaneously with the ILC and does nothing to alter the underlying nature of the relationship between the parties. Foreclosure of an ILC is the only process by which the buyer may be dispossessed.

An installment land contract should be treated as a conveyance. Although it does not always happen, the buyer should demand evidence of title even though the title insurance or the abstract will not be delivered until the buyer complies with the contract terms. Commission Rule E-5 applies to an ILC and requires the broker to provide settlement sheets (showing the purchase price, the costs, the pro-rating, and how the purchase price is to be paid) to the parties.

The installment land contract is a complicated and flexible instrument. It is also salable, making for further complications. The seller, the buyer, or the assignee may all be hurt if the instrument is improperly drafted or used. Whether used as an instrument of conveyance or a security device, the Commission strongly recommends consultation with competent legal counsel when considering use of an installment land contract.

An ILC (contract for deed) must also provide for:

- a. Designation of the public trustee of the county wherein the real property is located to act as escrow agent for the monthly payment by the purchaser of the monthly pro-rated property tax obligation on such property.
- b. The payment to the public trustee of the seller's tax obligation at closing for the current year's property taxes.
- c. The payment, by the purchaser, of the trustee's \$75.00 fee once each year in April. (38-35-126 C.R.S.)

These provisions must continue until the ILC is fulfilled and a deed to the property is delivered to the purchaser and recorded.

38-35-126(1)(b) C.R.S. defines a contract for deed as:

“a contract for the sale of real property which provides that the purchaser shall assume possession of the real property and the rights and responsibilities of ownership of the real property, but that the deed to such real property will not be delivered to the purchaser for at least one hundred and eighty days following the latest execution date on the contract for deed and not until the purchaser has met certain conditions such as payment of the full contract price or a specified portion thereof.”

Paragraph 2 of the same statute requires that:

"Within ninety days of executing and delivering a contract for deed to real property, the seller shall file with the county treasurer of the county wherein the real property is located a written notice of transfer by contract for deed to real property. Such notice shall not operate to convey title. Such notice shall include the name and legal address of the seller, the name and legal address of the purchaser, a legal description of the real property, the date upon which the contract for deed to real property was executed and delivered, and the date or conditions upon which the deed

to the real property will be delivered to the purchaser, absent default. In addition, within ninety days of executing and delivering the contract for deed to real property, the seller shall file a real estate transfer declaration with the county assessor of the county wherein the property is located, pursuant to the provisions of section 39-14-102, C.R.S."

The buyer has the option of voiding any contract for deed to real property that fails to designate the public trustee as escrow agent for deposit of property tax moneys or for which no written notice is filed with the county treasurer's office of the county assessor's office. Upon avoidance of such contract, the buyer is entitled to the return of all payments made on the contract, with interest, and reasonable attorney fees and costs. This avoidance right expires seven years after the latest execution date on the contract for deed to real property, unless exercised prior to such date. (38-35-126 (3), C.R.S.)

According to 38-35-126 (4) C.R.S., the above sections 1 & 3 do not apply if the:

- a.) subject property is not divided into parcels less than one acre.
- b.) developer (seller) pays the property tax or submits a bond or letter of credit within 30 days of the mailing of the notice of taxes due and prior to seeking reimbursement from the purchaser.
- c.) developer provides the notice of transfer mentioned in 38-35-126(2) C.R.S.

### **Manufactured, Modular And Mobile Homes**

The Division of Housing requires registration of persons who engage in the business of selling manufactured homes in Colorado under the Colorado Consumer Protection Act.

When engaging in the sale of mobile or manufactured homes, real estate brokers are subject to compliance with license law and the rules of the Real Estate Commission. A licensee may be disciplined for dishonest conduct or failure to account for money belonging to others. If the sale of a manufactured or mobile home is integrated with the sale or lease of land upon which the home is to be affixed or placed, a real estate license is required.

Manufactured and mobile homes may be conveyed by bill of sale if the sale is made prior to the home being affixed to the land. However, in the case of a manufactured home, instead of a formal bill of sale, a simple contract of sale would suffice because usually the manufactured home is immediately affixed to the land and would pass with a deed conveyance of the land.

Both mobile and modular homes are considered manufactured homes and C.R.S. Title 38 Article 29 governs title thereto.

A manufactured home seller must deliver a certificate of title to the buyer. Any person entitled to a certificate of title is required to make application to the director of revenue or the director's agent who is the clerk and recorder of the county in which the manufactured home is located. Copies of all applications are forwarded to the county assessor for tax purposes. The certificate of title is mailed to the owner of the manufactured home, unless the home is mortgaged, whereupon it is mailed to the mortgagee.

The notarized signature of the owner marks transfer of title. The buyer or transferee must present the transferred certificate, duly transferred, to the director of revenue or the director's agent within thirty days along with an application for a new certificate of title. If a manufactured home is destroyed or dismantled, the certificate of title must be surrendered to the director or the director's authorized agent.

When a manufactured home is permanently affixed to the ground and no longer capable of being drawn over the public highways, the owner may surrender the certificate of title to the director's authorized agent with a request that the title be purged. With the consent of the mortgagee the manufactured home will then become real property and the owner subject to all the rights and obligations of a real property owner.

Mobile homes and mobile home parks are subject to zoning requirements and there is often a problem of finding suitable space. Collusion between the owner of a mobile home park and the seller of the mobile home is forbidden by statute. A mobile home seller may not pay or offer to pay cash or other consideration to the owner of a mobile home park to reserve space and a mobile home park owner may not require that a mobile home be purchased from any particular seller as a condition of tenancy. Nor may a mobile home park owner require selling or transfer fees from tenants or buyers. The law also governs the amount of the security deposit and other matters. The **Mobile Home Park Act** (C.R.S. 38-12-Part 2) is printed in chapter 24 of this manual.

The construction of a manufactured or mobile home is subject to standards imposed by the Colorado Department of Local Affairs, Division of Housing which standards are identical to those of the United States Department of Housing and Urban Development (HUD). Absent such federal regulations, manufactured housing must be reasonably consistent with the American National Standards Institute (ANSI) Standard A-119.1. Standards do not apply to sales made after the first purchase (Title 24, Article 32, Part 7, C.R.S., as amended). The Colorado Department of Health establishes and enforces sanitary standards for mobile home parks (C.R.S. 25-1-107(m)).

Prior to engaging in the sale of manufactured housing, a real estate licensee should become thoroughly familiar with the associated federal, state and local requirements.

