

Modern Real Estate Practice in Illinois, 6th Edition
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Chapter 11: Real Estate Contracts

Learning Objectives

After reading this chapter, students should be able to:

- Identify the requirements for a valid contract.
- Describe the various types of contracts used in the real estate business.
- Explain how contracts may be discharged.
- Distinguish among bilateral and unilateral, executed and executory, and valid, void, and voidable contracts.
- Define the following key terms: assignment; bilateral contract; breach of contract; commingling; consideration; contingencies; contract; conversion; counteroffer; earnest money; equitable title; executed contract; executory contract; express contract; implied contract; installment contract; land contract; liquidated damages; novation; offer and acceptance; option; statute of frauds; suit for specific performance; time is of the essence; unenforceable contract; Uniform Vendor and Purchaser Risk Act; unilateral contract; valid; void; voidable.

WHY LEARN ABOUT REAL ESTATE CONTRACTS?

The real estate market is driven by contracts. Both listing and buyer representation agreements are contracts. Options are contracts, and an offer is the first half of a sales contract. Leases and escrows are contracts. Wherever you go as a real estate professional, whatever aspect of the real estate business you find yourself in, you will be dealing with contracts. And like any other tool of your profession, it is important that you know how a contract is created, what it means, what is required of the parties, and what kinds of actions can end it.

SUGGESTED ITEMS TO BRING TO CLASS

1. Copies of the following types of contracts, both blank and completed:
 - Listing agreements
 - Sales contracts
 - Option agreements
 - Land contracts
 - Buyer's representation agreements

2. Newspaper articles and periodical articles concerning contracts signed under the influence of drugs and under duress that were later disaffirmed by the court.

Lecture Outline

I. Contract Law

A contract is a voluntary agreement or promise between legally competent parties, supported by legal consideration, to perform (or refrain from performing) some legal act. A contract is a legally enforceable promise.

A. Express and Implied Contracts

- *Express contract*: the parties state the terms and show their intentions in words. An express contract may be either oral or written.
- *Implied contract*: the agreement of the parties is demonstrated by their conduct.

IN ILLINOIS . . . *the Illinois Statute of Frauds requires that contracts for the sale of land and leases that will not be fulfilled within one year from the date they are entered into must be in writing to be enforceable in court. The Illinois Real Estate License Act of 2000 also indicates that certain contracts, such as employment agreements between broker and salesperson, must be in writing.*

B. Bilateral and Unilateral Contracts

- *Bilateral contract*: both parties promise to do something; one promise is given in exchange for another. A real estate sales contract is a bilateral contract.
- *Unilateral contract*: a one-sided agreement. One party makes a promise to induce a second party to do something. The second party is not legally obligated to act.

C. Executed and Executory Contracts

- *Executed contract*: all parties have fulfilled their promises.
- *Executory contract*: One or both parties still have an act to perform.

D. Essential Elements of a Valid Conveyance

1. Offer and acceptance (mutual assent)

There must be an offer by one party that is accepted by the other.

- The person who makes the offer is the *offeror*; the person who accepts the offer is the *offeree*.
- There must be a meeting of the minds, or complete agreement, about the purpose and terms of the contract.

- An *offer* is a promise made by one party, requesting something in exchange for that promise. The terms of the offer must be definite and specific and must be communicated to the offeree.
 - An *acceptance* is a promise by the offeree to be bound by the exact terms proposed by the offeror.
 - Proposing any deviation from the terms of the offer constitutes a rejection of the original offer and becomes a new offer. This is known as a *counteroffer*.
2. **Consideration** is something of legal value offered by one party and accepted by another as an inducement to perform or to refrain from some act. A contract must be supported by good and valuable consideration.
 3. **Reality of consent**
A contract must be entered into as the free and voluntary act of each party.
 4. **Legally competent parties**
All parties to the contract must be of legal age and have enough mental capacity to understand the nature or consequences of their actions in the contract.

IN ILLINOIS . . . *all persons become of legal age on their 18th birthday. Contracts entered into by a minor in Illinois are voidable until the minor reaches majority and for a reasonable time afterward. There is no statutory period within which a person may void a contract after reaching majority. Contracts made by a minor for what the law terms necessities are generally enforceable.*

E. Validity of Contracts

1. A contract is *valid* when it meets all the essential elements that make it legally sufficient, or enforceable.
2. A contract is *void* when it has no legal force or effect because it lacks some or all of the essential elements of a contract.
3. A contract that is *voidable* appears on the surface to be valid but may be rescinded or disaffirmed by one or both parties based on some legal principle.
4. A contract that is *unenforceable* seems on the surface to be valid; however, neither party can sue the other to force performance.

II. Discharge of Contracts

A contract is discharged when the agreement is terminated.

A. Performance of a Contract

IN ILLINOIS . . . *a deed or contract executed on a Sunday or legal holiday is valid and enforceable. However, when the last day on which a deed or contract must be executed is a holiday or a Sunday, the deed or contract may be executed on the next regular business day.*

B. Assignment

The transfer of rights or duties under a contract.

C. Novation

The substitution of a new contract in place of the original.

D. Breach of Contract

A violation of any of the terms or conditions of a contract without legal excuse.

1. Seller's breach

- In a suit for specific performance involving a real estate contract, the buyer asks the court to force the seller to go through with the sale and convey the property.
- The buyer may choose to sue for damages, asking that the seller pay for any costs and hardships suffered by the buyer as a result of the seller's breach.
- Alternatively, the buyer may rescind or cancel the contract, and the seller must return any earnest money deposit.

2. Buyer's breach

- The seller can sue for damages or sue for the purchase price.
- The seller may declare the contract forfeited, in which case the seller may retain the buyer's earnest money as liquidated damages.
- In addition, the seller may sue for compensatory damages if the buyer's breach resulted in financial losses for the seller.

3. Statute of limitations

The law of every state limits the time within which parties to a contract may bring legal suit to enforce their rights. The statute of limitations varies for different legal actions. Any rights not enforced within the applicable time period are lost.

IN ILLINOIS . . . *the statute of limitations for oral contracts is five years; for written contracts, ten years.*

E. Termination

Contracts may also be discharged or terminated when any of the following occurs:

- Partial performance
- Substantial performance
- Impossibility of performance
- Mutual agreement
- Operation of law
- Rescission

III. Contracts Used In The Real Estate Business

The written agreements most commonly used by brokers and salespersons are: listing agreements and buyer agency agreements; real estate sales contracts; options; land contracts or contracts for deed; and leases and escrow agreements.

A. Contract Forms

IN ILLINOIS . . . *the 1966 Illinois Supreme Court decision in the case of Chicago Bar Association, et al. v. Quinlan and Tyson, Inc., placed certain limitations on brokers and salespersons in drafting a contract of sale. The court ruled that brokers and salespersons who are not lawyers are authorized only to fill in blanks and make appropriate deletions on printed form contracts that are customarily used in the real estate community. Real estate sales contracts that fit the "customarily used" requirement have typically been drafted by local bar associations and approved by local REALTOR[®] associations.*

All insertions and deletions must be based solely on factual information. A licensee may not request or encourage a party to sign a contract or document that contains blank spaces to be filled in later, after signing. All licensees are required to give each person signing or initialing an original contract a true copy of the document within 24 hours of the time of signing.

A licensee is also prevented from preparing or completing any document subsequent to or implementing the sales contract, such as a deed, bill of sale, affidavit of title, note, mortgage or other legal instrument.

B. Listing and Buyer Agency Agreements

A listing agreement is an employment contract. It establishes the rights and obligations of the broker as agent and the seller as principal. A buyer agency contract establishes the relationship between a buyer and his or her agent.

C. Customary Terms of Real Estate Sales Contracts

A real estate sales contract contains the complete agreement between a buyer of a parcel of real estate and the seller.

IN ILLINOIS . . . *a licensee may not use any form titled “Offer to Purchase” if the form is intended to become a binding real estate contract. Although such forms are legally considered to be only offers until accepted, Illinois law requires that such forms be clearly headed **Real Estate Sale Contract** in bold type.*

- Several details frequently appear in a sales contract in addition to the essential elements of a contract discussed previously. These include:
 - the sales price and terms.
 - a legally acceptable description of the land.
 - a statement of the kind and condition of the title, and the form of deed to be delivered by the seller.
 - the kind of title evidence required, who will provide it, and how many defects in the title will be eliminated.
 - a statement of all the terms and conditions of the agreement between the parties, including any contingencies.

1. Earnest money deposits

It is customary for a purchaser to provide a deposit when making an offer to purchase real estate.

IN ILLINOIS . . . *under the administrative rules established by the Office of Banks and Real Estate (OBRE) for administering the Illinois Real Estate License Act, all brokers must establish special trust (or escrow) accounts for the deposit of earnest money and other funds entrusted to them in connection with real estate transactions. A broker need not open a special escrow account for each earnest money deposit received, however, but may deposit all earnest money funds in one account. The rules require that the escrow account be noninterest bearing, unless federal law requires interest on the type of deposit being used. (If interest is paid on the deposit, the recipient of any accrued interest must be designated by the parties in writing.)*

Each broker must maintain a complete journal and ledger of all earnest money transactions and notify the OBRE of the name of the federally insured institution where the money is deposited. All funds must be deposited to that account no later than the next business day following the acceptance of the real estate contract. The rules require brokers to make a complete record of all escrow account activity. Both the account and the records are subject to inspection at any time by the OBRE.

Only the broker or an authorized agent may withdraw funds from the account. Fees and/or commissions earned by the broker that are to be paid from the funds in this account are to be disbursed by the broker from the account no earlier than the day the transaction is consummated or terminated, and no later than the next business day after consummation or termination of the transaction. Other payment schedules are allowed, however, if they are in accordance with the written directions of the principals to the transaction.

Brokers are strictly prohibited from commingling their own funds with funds in special accounts except for the purpose of maintaining a minimum running balance required by the depository. If a broker uses his or her own funds to avoid incurring service charges, scrupulous records must be kept. Brokers may not use escrow funds for their personal use; this illegal act is known as conversion.

2. Equitable title

When a buyer signs a contract to purchase real estate, he or she does not receive legal title to the land. However, once a sales contract has been executed, the buyer acquires equitable title.

3. Destruction of premises

Under the common law, the buyer always bore the risk of loss in the event the property was damaged or destroyed before closing. Court documents of most states, however, have increasingly placed the risk of loss on the seller.

IN ILLINOIS . . . *the Uniform Vendor and Purchaser Risk Act has been adopted. If the entire premises or a material part of it is destroyed, the seller cannot enforce the contract against the buyer. Any earnest money must be returned. If title or possession has been transferred to the buyer, he or she must still pay the full contract price.*

4. Liquidated damages

The parties may agree on a certain amount of money, called *liquidated damages*, that will compensate the nonbreaching party.

5. Contingencies: additional conditions that must be satisfied before a sales contract is fully enforceable. A contingency includes three elements:

- specific actions necessary to satisfy the contingency,
- time frame within which the actions must be performed, and
- person responsible for paying any costs involved.

6. Amendments and addendums

An amendment is a change to an existing contract. An addendum is any provision added to an existing contract without altering the content of the original.

IN ILLINOIS . . . *several mandatory disclosures are required of both sellers and agents, such as disclosure of property conditions and agency relationships. These disclosures may be included in the sales contract by physical attachment or by reference.*

D. Options

An *option* is a unilateral contract by which an optionor gives an optionee the right to buy (or lease) the owner's property at a fixed price within a certain period of time. The optionee pays a fee (the agreed on consideration) for this option right. An option contract is not a sales contract.

E. Land Contracts

Under a typical land contract, the seller (also known as the vendor) retains legal title. The buyer (called the vendee) takes possession and gets equitable title to the property. The buyer agrees to give the seller a down payment; to pay regular monthly installments of principal and interest over a number of years; to pay real estate taxes, insurance premiums, repairs and upkeep on the property. The seller is not obligated to execute and deliver a deed to the buyer until the terms of the contract have been satisfied.

IN ILLINOIS . . . *installment contracts (or articles of agreement) are commonly used when creative seller financing is needed to consummate a sale. Any provision in a contract or an agreement is void if it forbids the contract buyer to record the contract; provides that recording shall not constitute notice; or provides any penalty for recording.*

Any installment contract for the sale of a dwelling that consists of 12 or fewer units is voidable at the option of the buyer unless a certificate of compliance or an express warranty is attached to or incorporated into the contract that no notice of a building code violation has been received within the past ten years. If any notice has been received within the past ten years and not complied with, each notice must be listed with a detailed explanation. Neither buyer nor seller may waive this requirement.

A buyer who, under an installment contract, purchases residential property containing six or fewer units from a land trust must be told the names of all beneficiaries of the trust at the time the contract is executed. The buyer has the option of voiding the contract if the names are not revealed.

Discussion Questions

1. How do contractual agreements affect everyday life? How often are we engaged in some sort of contract, whether or not we are specifically aware of it?
2. What types of implied contracts are found in everyday life?
3. What does the phrase *time is of the essence* really mean?
4. Why is the phrase *specific performance* so important to real estate transactions?

Classroom Exercise

1. Distribute to each of your students a copy of the sales contract commonly used in your area. Refer to the lists in the text, and have your students find as many of these items as possible on the contract form and identify them by placing the corresponding item number in a circle at the appropriate place on the form.