

2010-2011 UPDATE COURSE

SECTION TWO

CONTRACT PRACTICAL EXERCISE

Outline:
<u>Introduction</u>
<u>Facts Underlying Hypothetical Contract</u>
<u>Practical Application Questions</u>
<u>Discussion of Practical Application Questions</u>
<u>Conclusion</u>

Learning Objective: The purpose of this Section is to give licensees an opportunity to work with the new contract provisions by applying terms of a hypothetical contract to different fact situations that might arise to enable licensees to better understand the application and interrelation of the new contract provisions and how they impact and effect the parties' rights. The hypothetical contract with the terms of the parties' agreement may be found at the end of this Section.

INTRODUCTION

Section One discussed the provisions of the 2011 Standard Form 2-T which became effective January 1, 2011. However, because concepts remain theory until they are applied, this practical exercise has been devised to facilitate discussion and to illustrate what might occur in a particular fact situation given the language of the new standard form contract. First, a hypothetical contract is created by providing licensees with the underlying facts. A series of questions is then posed for licensees to answer, based on the terms of the hypothetical contract reprinted at the end of this Section. Then the various fact situations posed by the questions are discussed and likely outcomes or results suggested.

To derive the most benefit from these materials, *licensees are urged to first attempt to answer the questions posed before reading all the answers.* After answering the first question, one may then address each question separately and consult the answer for that question only, but *refrain from reading ahead and learning the suggested outcome for subsequent questions before pondering the question and attempting to determine the answer for oneself.* Licensees who reason through the process will learn a lot more and gain a deeper understanding of the new contract provisions.

FACTS UNDERLYING HYPOTHETICAL CONTRACT

The following information and facts are used to create a sample Offer to Purchase & Contract utilizing the January, 2011 version of Standard Form 2-T. Following the establishment of the terms of the hypothetical Offer to Purchase & Contract, a series of questions or fact situations will be presented to be discussed and answered based on both the facts presented and the terms of the Hypothetical Contract that is reprinted at the end of the text. Again, licensees are urged to attempt to derive their own answers to the fact situations presented, before reviewing the answers in the Discussion section.

Underlying Facts

- The Buyer is Martin L. Brown and the Sellers are Harvey A. Thomas and Nancy E. Thomas. Sellers are represented by Broker Sue Ellen Sellars of We Sell Homes, LLC and Buyer is represented by Broker Hank Adams of NC Buyers First, Inc. Both agents and real estate companies have current and active licenses.
- The property is located at 313 Harmony Rd., Bliss, NC, 27869 and the deed to the sellers as grantees is recorded in Deed Book 7316, Page 264, Yadkin County Register of Deeds. The property was built in 1979 and the Thomases are the original owners. There are restrictive covenants that apply to the property, but no owners' association.
- Buyer signs an Offer on Saturday, July 10, 2010, which Hank delivers to We Sell Homes that afternoon along with the earnest money deposit check. Buyer's original offer includes the following terms:
 - Purchase price: \$270,000.00;
 - Due Diligence fee: \$250.00 by personal check payable to Harvey and Nancy Thomas and held by Hank;
 - Due Diligence Period extends through August 16, 2010;
 - Initial earnest money deposit: \$3,000.00 by personal check payable to We Sell Homes, LLC as escrow agent delivered with Offer;
 - Settlement Date: August 30, 2010;
 - No exceptions noted under the Fixtures paragraph and no personal property requested under Paragraph 3;
 - Buyer plans to obtain a 30 year conventional loan for 90% of the purchase price at a fixed interest rate not to exceed 6.5%;
 - Buyer must sell his current residence, but fails to attach the Contingent Sale Addendum;
 - Buyer has not received any Residential Property Disclosure Statement.
 - Buyer wants sellers to pay \$4,000.00 towards his closing costs.
 - No addenda are attached to the Offer.
 - Buyer is unaware of any proposed or confirmed assessments.
- Sellers receive Buyer's Offer the evening of July 10 and review it. They discuss it with Sue Ellen by phone on Sunday July 11 and she meets with the sellers on July 12. The sellers agree with most of buyer's proposed terms *except*: 1) they want a \$400 due

diligence fee and will then agree to the 30+ day due diligence period; 2) they want to take the chandelier in the dining room and the custom carved mailbox their grandson made with them; and 3) they only want to contribute \$3000.00 towards buyer's closing costs, but will agree to buy a one year home warranty from On Guard Company for \$450.00. Sellers make these changes to the Offer and initial them and then sign and date the Offer on Monday July 12 and Sue Ellen delivers it to Hank that afternoon.

- Hank finds the revised offer on his desk when he returns from showing property at 6:00pm on July 12 and reviews the changes. He telephones Martin and informs him of the changes the sellers have made to the Offer, which they then discuss. Martin agrees to the requested changes and arranges to meet with Hank the next day to initial and date the changes. Hank then calls Sue Ellen and tells her that Martin has accepted the changes, is meeting with Hank the following day at 2:00pm, and Hank will deliver a copy to her office late tomorrow afternoon. Martin keeps his appointment with Hank on Tuesday, July 13, initials and dates the four changes, receives a copy of the executed Offer from Hank and writes a check for \$400.00 payable to Harvey and Nancy Thomas. Hank delivers a copy of the contract and Martin's check for the due diligence fee to Sue Ellen's office at 4:00pm on July 13 and Sue Ellen signs acknowledging receipt of the earnest money deposit on behalf of We Sell Homes, LLC.
- Sue Ellen mails a copy of the contract and Martin's check for the due diligence fee to the Thomases on July 14 which they receive on July 15.

In the Notice Information Section both parties have provided contact information for their respective agents only and not for either the buyer or sellers.

PRACTICAL APPLICATION QUESTIONS

Based on the foregoing facts and the hypothetical contract appearing after these questions, answer the following questions or situations based on the terms of that Contract.

1. What is the "*Effective Date*" of the contract? _____ Why?
2. Martin submits a loan application on July 16 and notifies the lender that his due diligence period ends on August 16 and that the appraisal must be done before that date. The appraisal is conducted on July 31 and the appraiser submits his report to the lender on August 5. The appraiser values the property at \$268,000.00. The lender notifies Martin on August 9 that he has qualified for a 30 year conventional loan at 6.25% interest, but that the maximum loan it will extend is 90% of \$268,000.00, or \$241,200.00. What are Martin's options?
3. Assume that the property appraises at \$271,500.00 and that the lender notifies Martin on August 9 that he is approved for a 30 year conventional loan at 6.25% interest in an amount equal to 90% of \$270,000.00. Further assume that Martin is satisfied with the results of his

various investigations and inspections and decides on August 15 that he is going to proceed with the purchase. All is well until August 20 when Martin arrives at work only to be informed by his employer that Martin's job has been eliminated due to downsizing and that he now is unemployed. Must Martin notify the lender of this development? _____ Will he still qualify for the loan? _____ May Martin terminate the contract and receive a refund of his earnest money deposit?

4. Martin accepts an offer on his property that has an August 29 settlement date. Martin's lender approves Martin for a loan on terms acceptable to Martin, conditioned on Martin selling his current property that is under contract. On August 21, Martin's buyers inform him that they are unable to obtain the requisite financing and they will be unable to consummate the transaction. Can Martin terminate his contract to purchase and receive a refund of his earnest money deposit?

5. Martin has a home inspection performed on July 22 and receives the report on July 26, which recommends that he have an electrician check certain wiring and that a structural engineer be consulted regarding some cracks in both the foundation and two exterior walls. Martin hires both an electrician and an engineer to perform the recommended inspections and receives their reports on August 4. The electrician confirms that there are wiring problems in a later addition to the home and recommends that the addition be rewired which he estimates will cost between \$1,500 and \$1,800. The engineer reports that the cracks in the foundation and one wall are due primarily to settling and are not cause for concern, but that the crack in the other wall appears to be from some severe impact to the property and may bear monitoring. What are Martin's options?

6. Martin visits the property on August 2 following 2 days of fairly heavy rain. He notes standing pools of water in two or three locations, one of which abuts the house in the back. He asks the home inspector to again visit the property to check around the windows and doors for leakage and to check the moisture level in the crawl space. He also has a pest inspection done on August 4 that discovers evidence of a recent infestation in one section of the home, as well as damage to a girder and two joists arising in part from the wood-destroying insects. The home inspector finds no issues with the doors or windows, but notes excessive moisture in the crawl space that may have contributed to rotting of the girder and joists. Martin obtains estimates to repair the girder and joists from two different contractors; one estimates \$2,800 and the other \$3,500. They also recommend installing french drains to divert the water flow away from the foundation. What are Martin's options? What if Martin did not have a pest inspection or note any water pooling until August 18? What options might be available to him at that point?

7. What if Martin decides at the last minute to have the property surveyed on August 16. He learns on August 20 that a small portion of the lot may be in a flood zone. The lender notifies Martin that it will now require Martin to obtain flood hazard insurance. What, if any, options might he have?

8. Assume that in October, 2010, Martin receives a notice from the City that the first \$1,500.00 installment of a \$4,500.00 special assessment against the property is now due with subsequent

payments of \$1,500.00 due October 1, 2011 and October 1, 2012. The assessment was confirmed and became a lien against the property on June 1, 2010 on which date letters were mailed to all property owners affected by the assessment informing them of its confirmation. According to the contract, who is responsible for paying this assessment?

9. A) When may the listing company deposit the earnest money into its trust account?

B) What is the *final* date by which the listing company must deposit the earnest money deposit?

10. Listing company deposits the earnest money check into its trust account. The company receives a notice from its bank on Thursday, July 29 informing it that buyer's personal check has been dishonored. Sue Ellen's broker-in-charge sends her an email advising Sue Ellen of Martin's bounced check. What are the sellers' options?

11. Martin does a final walk-through prior to the settlement conference and discovers that the Thomases have removed the chandelier and the mailbox, plus the refrigerator, three ceiling fans, and two lovely ficus trees in clay planters which had been on the outdoor deck. What recourse, if any, might Martin have against the Thomases?

12. What if Sue Ellen realizes when reviewing the final contract that Martin has indicated that he never received a copy of the Residential Property Disclosure Statement. She faxes a completed Residential Property Disclosure Statement to Hank, Martin's agent, on July 15. The Thomases had checked "no representation" to all queries. May Martin terminate the contract based solely on his receipt of the Residential Property Disclosure Statement? What if Sue Ellen faxes Hank the completed Residential Property Disclosure Statement on July 18. May Martin terminate the contract based solely on his receipt of the Residential Property Disclosure Statement?

The parties' contract appears at the end of this Section. Review its provisions and answer the foregoing questions based on the contract's terms. The discussion of these questions follows, but it will be more beneficial if the reader already has attempted to answer each of the foregoing questions *before* they read the following materials.

DISCUSSION OF PRACTICAL APPLICATION QUESTIONS

The following is a discussion of the various issues raised by each question/fact situation from the “Practical Application” section. Again, licensees are *strongly* encouraged to answer each question first, and then read only the comments that correspond to that particular question. For ease of reference, the question/fact situation is reprinted below, followed by the “Comments.”

#1: What is the “*Effective Date*” of the contract? _____ Why?

Comments:

The Sellers’ signing the offer on July 12 is *not* the “Effective Date,” because the Thomases changed a few of the terms proposed by Martin. Because it was not a “mirror-image” acceptance, it constituted a counteroffer, which acted as a rejection of Martin’s offer. Even though Hank discussed the changes with Martin on July 12 and gained Martin’s oral acceptance of the changes and advised Sue Ellen by telephone of Martin’s acceptance on July 12, there still was no contract, as Martin could have changed his mind and refused to initial the changes on July 13. It was not until Martin actually initialed and dated his acceptance of the changes on July 13 *and* Hank communicated that acceptance to Sue Ellen by delivering the document to Sue Ellen that the parties actually had a contract. Thus, the “**Effective Date**” of the contract is Tuesday, **July 13, 2010**.

What if Martin had initialed and dated the changes on July 13 and Hank had telephoned Sue Ellen on that date and advised her that Martin had signed, but did not deliver a copy of the contract and the due diligence fee to Sue Ellen until July 14? The Effective Date still would be July 13 because Martin had signed the changes and Hank had communicated Martin’s acceptance to the sellers’ agent on that date. Does the fact that the sellers did not receive a copy of the fully executed contract and due diligence fee until July 15 impact the Effective Date? No, because pursuant to Paragraph 21, notice to a party’s agent is notice to the party.

What if Hank, instead of calling Sue Ellen on July 13, had deposited a copy of the executed contract in the United States Mail properly addressed to Sue Ellen at her office address on July 13? Absent express terms in the contract itself, the common law “mailbox rule” would apply and notice of acceptance would be deemed “communicated” to sellers through their listing agent upon deposit in the mailbox. Thus, the Effective Date of the contract would still be July 13, even though Sue Ellen might not receive the contract until July 14 or 15. If Hank did not telephone Sue Ellen and did not mail the contract and due diligence fee until July 14, then the Effective Date would be July 14.

What if Hank had delivered the sellers’ counteroffer to Martin on July 12 and Martin initialed and dated the changes on July 13 and *mailed* the signed counteroffer *to Hank* on July 13. Hank receives the signed document on July 14 and telephones Sue Ellen, informing her that Martin has signed. The Effective Date of the contract would be *July 14*, the date Hank communicated Martin’s acceptance to Sue Ellen. The *mailbox rule would not apply* in this scenario because Martin mailed the signed counteroffer *to his agent*, not to the sellers or the

sellers' agent; thus there was no communication of acceptance to the last offeror (sellers) until Hank telephones Sue Ellen on July 14.

#2: Martin submits a loan application on July 16 and notifies the lender that his due diligence period ends on August 16 and that the appraisal must be done before that date. The appraisal is conducted on July 31 and the appraiser submits his report to the lender on August 5. The appraiser values the property at \$268,000.00. The lender notifies Martin on August 9 that he has qualified for a 30 year conventional loan at 6.25% interest, but that the maximum loan it will extend is 90% of \$268,000.00, or \$241,200.00. What are Martin's options?

Comments:

Martin has several options. He may notify the Thomases in writing that he is terminating the contract, as his due diligence period has not expired. Alternatively, he could notify the Thomases that the property only appraised at \$268,000.00 and attempt to negotiate a reduction in the purchase price or, if they are unwilling to reduce the purchase price, perhaps they would agree to contribute more towards Martin's closing costs. Martin also could decide that he has sufficient resources to cover the \$1800.00 difference in the loan amount and move forward with the transaction. Bottom line is that if Martin does nothing and fails to exercise his unilateral right to terminate prior to 5:00pm on August 16, then he will forfeit his earnest money deposit in the event he fails to consummate the transaction (absent some material breach by sellers).

#3: Assume that the property appraises at \$271,500.00 and that the lender notifies Martin on August 9 that he is approved for a 30 year conventional loan at 6.25% interest in an amount equal to 90% of \$270,000.00 (i.e., \$243,000.00). Further assume that Martin is satisfied with the results of his various investigations and inspections and decides on August 15 that he is going to proceed with the purchase. All is well until August 20 when Martin arrives at work only to be informed by his employer that Martin's job has been eliminated due to downsizing and that he now is unemployed. Must Martin notify the lender of this development? _____ Will he still qualify for the loan? _____ May Martin terminate the contract and receive a refund of his earnest money deposit?

Comments:

Martin *clearly* must notify the lender of his changed circumstances. Martin's loan approval is based in large part on his representation that he is gainfully employed earning gross income of \$XXX per month or year. If that fact changes, then he **must notify the lender**, as it would be loan fraud not to disclose that he no longer has an income. He probably will no longer qualify for the loan previously approved without a source of income.

May Martin still terminate the contract and receive his earnest money back since he now no longer qualifies for the loan due to factors beyond his control? While the parties may agree to terminate the contract, since Martin will not be able to consummate the transaction without financing, he is *not* entitled to a refund of his earnest money deposit under the contract as his due diligence period has expired. The Thomases are entitled to retain both the due diligence fee and the earnest money deposit as liquidated damages. Could the parties agree that the earnest money

be divided equally between the parties or be refunded to Martin, even though the Thomases are entitled to it under the contract? Absolutely.

Is Martin's loss of employment, and thus income, a material fact? *Absolutely*. Martin, or at least Hank, is obligated to disclose Martin's loss of employment to the sellers, through their listing agent, as well as to the lender and to the settlement agent.

#4: Martin accepts an offer on his property that has an August 29 settlement date. Martin's lender approves Martin for a loan on terms acceptable to Martin, conditioned on Martin selling his current property that is under contract. On August 21, Martin's buyers inform him that they are unable to obtain the requisite financing and they will be unable to consummate the transaction. Can Martin terminate his contract to purchase and receive a refund of his earnest money deposit?

Comments:

Martin no longer has the right to unilaterally terminate the contract, as his due diligence period expired at 5:00pm on August 16. Martin's buyers' inability to close will now sabotage his approved loan and he will not be able to purchase the Thomas's property without financing; thus, the parties may enter into a termination of contract, but the Thomases will be entitled to receive the earnest money deposit under the terms of the contract, because Martin (and Hank) neglected to attach the Contingent Sale Addendum to the contract. Thus, the fact that Martin had to sell his property in order to purchase the Thomas's property remained only a representation in Paragraph 5(b) and did not rise to the level of a *condition* of the contract that would excuse Martin's performance.

#5: Martin has a home inspection performed on July 22 and receives the report on July 26, which recommends that he have an electrician check certain wiring and that a structural engineer be consulted regarding some cracks in both the foundation and two exterior walls. Martin hires both an electrician and an engineer to perform the recommended inspections and receives their reports on August 4. The electrician confirms that there are wiring problems in a later addition to the home and recommends that the addition be rewired, which he estimates will cost between \$1,500 and \$1,800. The engineer reports that the cracks in the foundation and one wall are due primarily to settling and are not cause for concern, but that the crack in the other wall appears to be from some severe impact to the property and may bear monitoring. What are Martin's options?

Comments:

Martin may unilaterally terminate the contract by providing written notice to the Thomases, via Sue Ellen, prior to 5:00pm on August 16 that he is exercising this right, or he may attempt to negotiate a resolution with the Thomases such that they agree to pay for repairs. If the parties are able to reach an agreement as to the repair issues, then *the agreement should be reduced to writing and signed and dated by all parties prior to the expiration of Martin's due*

diligence period. Any such agreement would then be an addition or supplemental agreement to the contract that should be provided to both the lender and the settlement agent.

Martin may also wish to ask the Thomases certain questions, such as who constructed the addition, when, were the necessary permits obtained, and what, if anything, hit the house that might have caused the severe impact, e.g. a car, a falling tree? Note too that the Thomases *are not compelled to answer Martin's questions*, but if they do, they must answer honestly. If the Thomases have revealed any of this information to Sue Ellen, she most likely *must disclose* what she knows to Martin and/or Hank as it probably is a material fact. Martin also may wish to check with the county or city Inspection Department to confirm that the requisite permits were obtained for the addition, because if they were not, he may have a problem and it may increase his costs to cure that oversight by obtaining the proper permits now. If Martin promptly begins these discussions on August 4 or 5, he still has adequate time to resolve these matters. If they are not resolved to his satisfaction by August 15, then it is **imperative** that he ensure that written notice of termination is delivered to Sue Ellen's office **no later than 5:00pm on August 16** or he will lose his right to unilaterally terminate and receive a refund of his earnest money deposit. If he fails to timely provide written notice of termination and later refuses to close, then the Thomases will retain both the due diligence fee and the earnest money deposit as liquidated damages.

[Would these be eligible repair requests under former Alternative 1, if the proper permits had been obtained for the addition?]

#6: Martin visits the property on August 2 following 2 days of fairly heavy rain. He notes standing pools of water in two or three locations, one of which abuts the house in the back. He asks the home inspector to again visit the property to check around the windows and doors for leakage and to check the moisture level in the crawl space. He also has a pest inspection done on August 4 that discovers evidence of a recent infestation in one section of the home, as well as damage to a girder and two joists arising in part from the wood-destroying insects. The home inspector finds no issues with the doors or windows, but notes excessive moisture in the crawl space that may have contributed to rotting of the girder and joists. Martin obtains estimates to repair the girder and joists from two different contractors; one estimates \$2,800 and the other \$3,500. They also recommend installing french drains to divert the water flow away from the foundation. What are Martin's options? What if Martin did not have a pest inspection or note any water pooling until August 18? What options might be available to him at that point?

Comments:

As in the preceding question, Martin may decide that this is not what he bargained for and may provide written notice to the Thomases prior to 5:00pm on August 16 that he is terminating the transaction and receive a refund of his earnest money deposit, or he may choose to negotiate any issues he wishes with the Thomases. The negotiations may be oral or in writing. He may ask that they pay \$3,000 towards the repair of the girder and joists *and* pay to have a french drain installed, and the Thomases may respond in any manner they wish. *Brokers must understand that any and all issues are subject to (re)negotiation during the due diligence period.*

If Martin presents a written request for repairs to the Thomases on August 7, is there any date by which the Thomases must respond? No, unless one is stated in Martin's request and even then, it is not binding on the Thomases – it merely is part of Martin's request. Martin, *and Hank*, must understand that *if any issues have not been resolved in writing and signed by all parties prior to August 16, then Martin, through Hank, **must deliver written notice of termination to the sellers (in this case through Sue Ellen) no later than 5:00pm on August 16 in order for Martin to be released from the contract and receive a refund of his earnest money deposit.***

Delivery of Notice

What if Martin decides at noon on August 16 that he does *not* want to proceed with the transaction and instructs Hank to notify Sue Ellen in writing that he is terminating the contract. Hank uses a standard form provided by his company for this purpose and deposits it in the United States Mail addressed to Sue Ellen at her office. Is this sufficient? **NO**. The contract expressly states in Paragraph 4(g) that buyer must **deliver to seller written notice of termination during the Due Diligence Period** (or any agreed-upon *written extension* of the Due Diligence Period). **The “mailbox rule” does not apply to delivery of the termination notice.** (As noted in Section 1, the “mailbox rule” generally applies only to a method of communicating acceptance of a contract!)

Thus, Hank or Martin or some office assistant needs to get in a car and personally physically deliver the notice Hank has prepared to Sue Ellen's office and, preferably, obtain a written acknowledgment from either Sue Ellen or someone at We Sell Homes, LLC that the notice was delivered at XX hour on August 16. What if Hank telephones Sue Ellen at 4:15pm on August 16 to notify her that he is on his way to her office to deliver Martin's notice of termination, but en route he encounters a traffic jam and does not arrive at her office until 5:10pm? Hank and Martin have a problem, because written notice of termination was not timely delivered to seller or sellers' agent and Martin remains bound by the contract. He will forfeit his earnest money if he fails to close.

What if Hank *faxes* the notice to Sue Ellen at 3:30pm on August 16, but he fails to check the transmission report to confirm the fax was delivered? He learns the next day that in fact the transmission did *not* go through for whatever reason. The result is the same as in the preceding paragraph; Hank has a problem because Martin has lost his right to terminate for failure to timely *deliver* written notice. What if Hank emails written notice to Sue Ellen at her email address provided in the Notice Information section at 3:30pm on August 16 and the notice is received by Sue Ellen's server, but Sue Ellen does not check her email and discover the notice until 10:00am on August 17? Typically, *email notices are deemed “delivered” upon receipt by the addressee's server*, regardless of when read by the recipient. Thus, the notice would be timely and Martin is entitled to a refund of his earnest money deposit. Prudent brokers will *retain some proof of delivery* in their transaction file.

Note: If Sue Ellen had written “N/A” next to the fax number and email address lines on page 9, then neither fax nor email would be an approved delivery method and arguably may not effectively release Martin from the contract if termination was communicated/delivered via an unapproved method.

What if Martin did not have a pest inspection or note any water pooling until August 18? Martin is out of luck. There is very little he can do at this point, as his due diligence period has expired. While he may conduct further inspections or investigations following the expiration of the due diligence period if he wishes (since seller must allow reasonable access through the earlier of closing or buyer possession), he no longer has the right to unilaterally terminate the contract. If he fails or refuses to close, then the Thomases will be entitled to the earnest money deposit as liquidated damages, as well as retaining the due diligence fee.

#7: What if Martin decides at the last minute to have the property surveyed on August 16. He learns on August 20 that a small portion of the lot may be in a flood zone. The lender notifies Martin that it will now require Martin to obtain flood hazard insurance. What, if any, options might Martin have?

Comments:

Martin doesn't have many options; he failed to order the survey in sufficient time to allow him to receive the results prior to the expiration of the due diligence period. He must comply with the lender's requirements in order to obtain the loan. If he cannot or will not comply and does not obtain financing on whatever terms, his performance is not excused as there is no loan condition in the 2011 form. If Martin fails to close, he will be in breach of contract and the Thomases will be entitled to receive the earnest money deposit as liquidated damages, as well as the due diligence fee.

[What would the result have been under the 2008 contract?]

#8: Assume that in October, 2010, Martin receives a notice from the City that the first \$1,500.00 installment of a \$4,500.00 special assessment against the property is now due with subsequent payments of \$1,500.00 due October 1, 2011 and October 1, 2012. The assessment was confirmed and became a lien against the property on June 1, 2010 on which date letters were mailed to all property owners affected by the assessment informing them of its confirmation. According to the contract, who is responsible for paying this assessment?

Comments:

Under Paragraph 7(d), sellers are supposed to disclose whether there are any proposed or confirmed assessments against the property. As to proposed assessments, they represent that "[t]o the best of Seller's knowledge ..." there either are or are not any pending proposed assessments. However, as to *confirmed* assessments, i.e., one that has been approved and is a given, sellers *warrant* that there either are or are not any confirmed assessments. Further, Paragraph 8(I) states that "...Seller *shall pay all Confirmed Special Assessments*, if any, provided that the amount thereof can be reasonably determined or estimated." Under the facts presented, the assessment was confirmed on June 1, 2010 and letters sent to each property owner affected by the assessment informing them of its confirmation and presumably the amount and payment schedule.

The Thomases breached the warranty by failing to disclose the confirmed assessment, whether the failure was intentional or negligent. The contract assigns financial responsibility to the sellers for all confirmed assessments. The Thomases should have paid the \$4,500.00 assessment at closing. It would appear that Martin has a valid cause of action against them under the contract to indemnify him from any liability for this assessment. Will the City absolve Martin from payment and hold the Thomases liable? No. The City of Bliss will look to Martin for payment and could at some point attempt to force a sale of his property to satisfy the lien if he refuses to pay it voluntarily. Martin's recourse is to seek indemnification from the Thomases.

What if the assessment had only been *proposed* prior to the parties entering into their contract and had not been confirmed until October 2010 with the first of three payments due in January 2011? Most likely, Martin would be liable for paying the entire assessment and would have no recourse against the Thomases unless he could show that they or the listing company or Sue Ellen knew or should have known about the proposed assessment.

#9: A) When may the listing company deposit the earnest money into its trust account?

B) What is the *final* date by which the listing company must deposit the earnest money deposit?

Comments:

This is something of a trick question, in that the listing company *may* deposit the earnest money immediately upon receipt. The Commission's trust account rule (Rule A.0107) generally requires that *all monies received by a licensee in a fiduciary capacity be deposited in a trust or escrow account within three banking days of receipt*. However, the Rule *permits*, but does *not require*, a licensee to hold earnest money deposits and tenant security deposits *received in the form of a check or money order* ("negotiable instrument") *until contract acceptance*. The licensee then has three banking days from contract acceptance (i.e. Effective Date) within which to deposit the funds into a trust or escrow account.

Thus, in the instant situation, the listing company could have deposited the earnest money into a ***non-interest bearing*** trust account when they received it on July 10 (as there is no contract and thus no authorization for deposit into an interest-bearing trust account at that point). Had the earnest money been paid in *cash*, rather than by personal check, the listing company's three banking day clock would have begun ticking on July 10 (a Saturday), the date on which it received the cash. The listing company would have been required to deposit the cash earnest money deposit into its trust account no later than Wednesday, July 14. However, because the earnest money was paid by check, and because there was no contract until Tuesday, July 13, the listing company/agent has until 5:00pm on Friday, July 16, to deposit the funds into its trust/escrow account. At that point, the earnest money check could have been deposited into an interest-bearing trust account as authorized by the parties in Paragraph 1(f) of the contract.

What if the listing company had deposited the earnest money check into its trust account on July 10, sent the sellers' counteroffer to Hank on July 12, and been notified by Hank by telephone on July 13 that Martin had found a different property, was not interested in negotiating

any further with the sellers, and wanted his earnest money check back. Could the listing company refund Martin's earnest money on July 14 or 15? Probably *not*, as the listing company should not release the funds until it is sure that Buyer's check was honored which, even with a local check, may be 7 - 10 days from deposit, and even longer with out-of-state checks. This is one reason the Commission's rule allows an agent to hold an earnest money *check* (or other negotiable instrument) until contract acceptance. Had the earnest money been paid in *cash*, the listing company could have deposited it into a non-interest bearing trust account on July 11 or 12 and written a check to the buyer on July 13. (Understand that ***cash must ALWAYS be deposited within three banking days of receipt, regardless of its purpose.*** There are no exceptions for cash, as cash is immediately refundable.)

#10: Listing company deposits the earnest money check into its trust account. The company receives a notice from its bank on Thursday, July 29, informing it that Martin's personal check has been dishonored. Sue Ellen's broker-in-charge sends her an email advising Sue Ellen of Martin's bounced check. What are the sellers' options?

Comments:

Sellers must notify buyer *in writing* (in this instance, through buyer's agent) that his personal check has not been honored and that buyer has one banking day to produce good funds. If Martin fails to timely produce good funds, the Thomases may terminate the contract upon written notice to Martin (via Hank). (See Paragraph 1(d).) If Sue Ellen sends Hank a fax or email on July 29 notifying him of Martin's dishonored check, then Hank must *immediately* inform Martin, as Martin must produce good funds by Friday, July 30. If Sue Ellen does not notify Hank in writing of the bounced check until July 30, then Martin will have until Monday, August 2, to produce good funds for the \$3,000.00 earnest money deposit. "Good funds" may include cash, certified bank check or a wire transfer directly into the listing company's trust account. Failure to produce good funds allows sellers to terminate the contract by delivering written notice of termination to Hank any time thereafter prior to receiving good funds. Note that sellers may, but are not required to, terminate the contract.

What if Martin, for whatever reasons, does not produce good funds until Tuesday, August 3, but the Thomases have not provided any written notice of termination to Hank or Martin as of August 3? Presumably, the sellers' right to terminate the contract based on dishonored funds is waived if not exercised prior to the receipt of good funds, even if the funds are not paid until 2 or 3 banking days after written notice to buyer. While the contract does not explicitly state this, it would seem that the sellers' ability to terminate should cease upon receipt of the good funds if the right has not been exercised prior thereto as the default or breach has been cured.

#11: Martin does a final walk-through prior to the settlement conference and discovers that the Thomases have removed the chandelier and the mailbox, plus the refrigerator, three ceiling fans, and two lovely ficus trees in clay planters which had been on the outdoor deck. What recourse, if any, might Martin have against the Thomases?

Comments:

The Thomases were entitled to remove the chandelier and the custom-made mailbox, as both were expressly excepted under Paragraph 2 of the contract. Assuming that the refrigerator was not a built-in appliance, (as most are not), then that too does *not* automatically convey to buyer under Paragraph 2. If Martin had wanted the refrigerator, it should have been included in Paragraph 3. The two lovely ficus trees on the deck in clay planters also seem to be covered by the preprinted language in Paragraph 2 which states that only “...outdoor plants and trees (*other than in movable containers*)...” are considered “fixtures” that convey to buyer. Thus, assuming the planters were movable (albeit heavy), Martin probably does not have a valid claim concerning the removal of these items.

The ceiling fans, however, are expressly covered in Paragraph 2 and are supposed to automatically convey to the buyer as a fixture unless the seller reserves the right to remove them by excepting them on the blank lines where indicated. Accordingly, Martin may demand that the Thomases either restore the three ceiling fans improperly removed or provide comparable replacements within a reasonable time. Would the removal of the ceiling fans by the Thomases constitute a *material breach* of the contract allowing Martin to terminate the contract or refuse to close? Probably not, as the transgression is readily remedied by either replacing the fans or paying for the purchase of new ones.

#12: What if Sue Ellen realizes when reviewing the final contract that Martin has indicated that he never received a copy of the Residential Property Disclosure Statement. She faxes a completed Residential Property Disclosure Statement to Hank, Martin’s agent, on July 15. The Thomases had checked “no representation” to all queries. May Martin terminate the contract based solely on his receipt of the Residential Property Disclosure Statement? What if Sue Ellen faxes Hank the completed Residential Property Disclosure Statement on July 18. May Martin terminate the contract based solely on his receipt of the Residential Property Disclosure Statement?

Comments:

Many licensees seem to be confused about when the Residential Property Disclosure Statement must be given and the consequences of failing to provide the buyer with a copy of the statement prior to the buyer making an offer. The Disclosure Statement itself, as well as Paragraph 5(d) of the contract, outline the consequences. If the buyer *has* received a copy of the Residential Property Disclosure Statement *prior to signing an offer*, then the statute is satisfied and there are no consequences because the mandatory form has been provided. If, however, the buyer has *not* received a signed copy of the disclosure statement prior to signing the offer, then the *buyer*

“... shall have the **right to terminate or withdraw this Contract** without penalty prior to **WHICHEVER OF THE FOLLOWING EVENTS OCCURS FIRST:** (1) the end of the third calendar day following receipt of the Disclosure Statement; (2) the end of the third calendar day following the date the Contract was made; or (3) Settlement or occupancy by Buyer in the case of a sale or exchange.” (Emphasis added.)

Under the facts posed, the “Effective Date” of the contract was July 13. If Martin receives the signed Residential Property Disclosure Statement on July 15, then he may terminate the contract by July 16 based solely on the receipt of the disclosure statement, even though it reveals nothing. Remember, buyer has *three calendar days within which to terminate either 1) from the date he receives the Statement, or 2) from contract formation, whichever occurs FIRST*. In this case, three days from contract formation is July 16, not July 18 which would be three calendar days from buyer’s receipt of the disclosure statement. Accordingly, *Martin has until July 16 to terminate the contract based solely on not having received a signed copy of the Residential Property Disclosure Statement prior to making an offer.*

A buyer always has the right to rescind or terminate a contract within three days from contract formation, if the buyer did not receive a signed copy of the disclosure statement prior to making an offer, even if the buyer never receives a copy of the Statement. The buyer’s right to rescind expires beginning the fourth day after contract formation and is not revived by later receipt of the statement. Thus, if Martin does not receive the statement until July 18, he will not be able to rescind the contract solely based upon the receipt of the disclosure statement. That right expires for all purposes at the end of the third day following contract formation. A seller may eliminate buyer’s right to rescind post-contract formation merely by providing buyer with a copy of the signed disclosure statement *prior* to the buyer submitting an offer. However, because Martin is still within his due diligence period, he may unilaterally terminate the contract for any or no reason.

NOTE too that the Commission imposes an affirmative obligation on both seller agents and buyer agents to do their utmost to ensure that, where required, sellers provide prospective buyers with a signed copy of the mandatory disclosure form prior to making an offer, even though the seller is not compelled to reveal anything about the property given the “no representation” option.

Earnest Money Deposits

Should there ever be a dispute over an earnest money deposit under the 2011 form? *Rarely*. The contract clearly expresses the **RULE**, namely: **the Buyer receives a refund of the earnest money deposit if Buyer TIMELY delivers notice of termination to the Seller/listing agent prior to the expiration of the due diligence period; otherwise, the Seller is entitled to the earnest money deposit in all other cases unless the seller breaches or fails to materially perform.** Thus, the primary question will be: *did the buyer timely deliver written notice of termination to the seller/listing company?* If yes, then the buyer receives the earnest money deposit; if no, then the seller receives the earnest money deposit. A party who stubbornly refuses to consent to the release of the earnest money deposit without any legitimate foundation should be reminded that s/he may be liable for a portion of the other party’s attorney fees if the party entitled to the earnest money deposit must sue to recover it. Gone, however, are the squabbles over whether the requested repair was “legitimate” or whether the buyer’s estimated cost of repairs was reasonable, etc.

CONCLUSION

As with any new rule or law or form, it will take time to fully understand the implications and application of the new contract provisions and how they relate to other addenda. Licensees are encouraged to consult the appropriate Guidelines prepared by the Joint Forms Task Force, once the Guidelines are approved and available, for further instruction on how to complete the new forms. It is important that licensees understand the new contract and related addenda in order to complete these forms competently, as they will become the foundation of the real estate transaction and govern the parties' respective rights and obligations. If licensees are uncertain or confused about any form, they should seek additional education and training, either through continuing education, or their REALTOR® organization, or the 30-hour post-licensing course dedicated to contracts and closing, or through in-house training provided by their real estate company. At the very least, when in doubt they should consult their broker-in-charge for advice, and possibly the company's attorney, or recommend that a party seek legal counsel if a party wants to alter the Standard Form significantly or has several questions concerning the legal implications of the contract.