Chapter 1 covers the basic elements of a contract, types of agreements and the parties involved.

**CHAPTER LEARNING OBJECTIVES**

Upon completion of this chapter, the student should be able to:

- Describe the basic elements of a valid contract
- List the main types of contracts most used in residential sales transactions
- Understand when it’s appropriate and/or necessary to seek professional/legal assistance
Introduction

Contracts are an essential part of the transfer of real estate. It is important that you, as the real estate professional, are familiar with these contracts, know how to use them and have the ability to explain the terms contained within these forms.

These forms aid in the development of a legally binding contract between the parties and express the terms, conditions, timeline and promises of the seller and the purchaser.

Should an issue or dispute ever arise between the parties to a contract, these forms and their content will be of the utmost importance in arbitration or in a court of law.

In this course, we will be referring to the contract between the buyer and the seller for the purchase of real property as a Purchase and Sale Agreement (PSA).

Elements of a Valid Contract

For a legal contract to be binding, the following elements must exist:

- **Mutual agreement/acceptance**: Each and every party involved in the contract must agree to and accept the contract and its components. All parties must recognize and acknowledge that an agreement has been made and duly accepted.

- **Consideration**: A contract must be mutually beneficial and all parties must recognize and accept the benefits from the contract. These benefits can include money, transfer of ownership, transfer of rights, exchange of services, or anything of value.

- **Legally competent parties**: In the United States, a person or entity (such as a business, trust or corporation) must be competent and at least 18 years old to enter into a contract. If the party is a business, the person representing the business must also be legally competent and have the authority to act for the business.
• **Lawful Objective:** A legal contract cannot require any party to knowingly break the law. If so, the contract is usually void.

• **Written Contract:** The Statute of Fraud in most states requires that all real estate contracts be in writing.

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**Void and Voidable Contracts**

**Valid Contracts** - if a contract has all of the required elements (see elements of a legal contract), then it is valid and enforceable in a court of law. An example of this would be a homeowner (who is usually over the age of 18 and of sound mind) who signs a contract with the appliance store to buy a refrigerator.

**Void Contracts** - a void contract is not a contract and has no effect in a court of law. Most commonly, a void contract will be missing one or all of the essential elements needed for a valid contract (again, see elements of a legal contract).

**Voidable Contracts** - a voidable contract is a contract which may appear to be valid, but has some type of flaw which could cause **one or both** of the parties to void the contract. An example of this would be a contract between an illegal drug dealer and an illegal drug supplier to purchase a specified amount of drugs for a specified amount. Either one of the parties could void the contract since there is no lawful objective and hence missing one of the elements of a valid contract.

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**Statute of Frauds**

What is the Statute of Frauds?

A “statute of frauds” requires that certain types of contracts be in writing and that they must be signed (acknowledged) by all of the parties that will be bound to the contract.

**Contracts involving the sale or transfer of real property in most states fall under the statute of frauds law and must be in writing.** Real Estate contracts not in writing are not enforceable.
Its origins come from the English Parliament in the 1600’s.

**Why This is Important for Real Estate Contracts:**

Historically, especially when real estate was conducted with a handshake, the opportunities to commit acts of fraud were abundant.

There are some basic reasons why all real estate contracts should fall under this statute:

The purchase or transfer of real property often involves many terms and conditions as well as pricing. Because of this, the need for having these agreements in writing is essential.

Also, there may be many contingencies in the contract which have deadlines for completion. If these deadlines are not met, there can be serious consequences for either party. Again, having these agreements in writing provides clarification for all the parties.

Should there be any dispute between the parties in a contract; the issue may require arbitration or intervention through the courts. Should this arise, an arbitrator or judge could obtain a clearer understanding, of the intentions and promises between the parties by reviewing a written contract stating the specific agreements in the contract.

**Purchase and Sale Agreement (PSA)**

A Purchase and Sale Agreement is used when a buyer (the offeror) intends to make an offer to the seller (the offeree). Since the Statute of Frauds requires all real estate offers to be in writing in most states, the PSA is used for this purpose. Included in the PSA are all of the terms and conditions of the purchase and the time frames in which certain actions must be performed.

The PSA will typically specify some the following:

- Purchase Price
- Closing Date
- Date of the contract
• The multiple listing number if it has one
• The full names of all the purchasers
• The common address and county where the property is located

**A legal description**
• Included items, such as appliances, wood stoves, security systems
• Earnest money and default
• Information about disclosures
• Contingencies
• Information about the title company
• Information about the closing or escrow agent
• Closing date and date of possession
• Offer expiration date
• Service of closing agent for payment of utilities
• Charges and assessments due after closing
• Agency disclosure
• What addenda are attached to the contract?
• Buyer’s address, phone, fax and e-mail address and signature
• Seller’s address, phone, fax and e-mail address and signature

Please take note from the above list that the legal description is in bold type. Without a legal description in most states, a PSA is voidable.

The type of Purchase and Sale Agreement (PSA) that will be used will depend on the property. The various types most commonly used by residential agents are:
• PSA for Single Family Homes
• PSA for Multi-Family Homes
• PSA for Vacant Land (Unimproved property)
• PSA for Condominiums

The PSA is usually completed by the broker working with the buyers, then signed by the buyers and presented to the sellers
Listing Agreements

When a licensee lists a property for sale, a listing agreement acts as a contract between the seller and the licensee (in actuality between the seller the brokerage). It is like an employment contract in some ways, but it is between a seller and an independent contractor (the licensee).

The listing agreement will normally specify the following items:

- The common address for the property
- **The legal description**
- The length of time of the listing
- The licensee and the brokerage company
- The rate of commission
- Recourse in the event the seller sells the property
- Disclaimer on Distressed Homes
- Authorization to install a key box
- Seller’s warranties and representations regard the right to sell and encroachments
- Seller’s indemnification to hold agent harmless if their representations are incorrect
- Brief information on closing costs
- Permission from the seller to be listed in NWMLS and that their agent can cooperate with other members of the MLS
- Disclaimer regarding insurance
- Broker’s right to market the property
- Brief information on the seller’s disclosure statement
- Consequence and damages in the event of a buyer’s breach
- Attorney’s fees

From the above list, please note that the legal description is in bold type. It is one of the most important components of the listing. Without the legal description in most states, the listing agreement is voidable. This means that either party can cancel the contract. Please make note that the legal description of the property, which can be obtained from the last deed and supplied by the title company, is not the same as the street address.
There are two types of listing agreements depending on the state that you’re in: Exclusive Sale and Listing Agreement and Exclusive Agency Sale and Listing Agreement. Let’s take a closer look at each:

**Exclusive Sale and Listing Agreement** – allows the broker to earn the listing portion of the commission, no matter who sells the property. Shown below.

Please refer to the chapter on listing agreements to view a listing form.

**Exclusive Agency Sale and Listing Agreement** – the broker does not earn the listing portion of the commission if the seller produces a sale.

Please note that while a licensee may take the listing, that licensee is an agent for the broker and the broker or brokerage owns the listing.

**Conditional Release of Listing**

The Conditional Release of Listing is another common contract that residential brokers use. In essence, it rescinds the listing agreement with the condition that the seller will still pay the broker a commission if a future buyer purchases the property and has identified the property through the means of the broker’s advertising or showing within six months.

**NOTE:** When a listing is rescinded, each party is put back to their original position.

**Buyer’s Agreement**

Commonly used by residential brokers in most states is the Buyer’s Agreement. There are two types: Buyer’s Agency Agreement and Buyer’s Agreement No Agency:

**Buyer’s Agency Agreement**- states that a licensee represents the buyer and that the buyer has an obligation to that licensee for commission during the term of the agreement. This agreement is unilaterally cancelable by either party and must be done in writing. If two brokers are ever in a dispute over commission, a buyer agency agreement can be the proof that a particular licensee would be entitled to earn a commission.
**Buyer’s Agreement No Agency**-this contract states the licensee does not represent the buyer, even though they may be performing brokerage services for the buyer.

**Legal Descriptions**

When taking a listing, it is of extreme importance to obtain a full legal description from the last deed and have it initialed by the seller(s). A street or common address is not sufficient and the listing agreement could be voidable.

For a Purchase and Sale Agreement the same holds true, and the full legal description must be initialed by both the buyer and the seller.

**Full Legal Description Example:**
The Grantor Paul S. Post and Mary B. Post, husband and wife

For and in consideration of TEN DOLLARS AND OTHER GOOD AND VALUABLE CONSIDERATION in hand paid, conveys and warrants to Peter D. Sanders and Kim H. Sanders

The following described real estate situated in the county of SNOHOMISH, State of Washington

LOT 14, HAYWOOD HILLS, ACCORDING TO THE PLAT THEREOF RECORDED ON VOLUME 32 OF PLATS, PAGES(S) 121-123, INCLUSIVE RECORDS OF SNOHOMISH COUNTY, WASHINGTON. SITUATED IN THE COUNTY OF SNOHOMISH, STATE OF WASHINGTON

**Contracts for Lease Options and Leases**

A written contract is required for the sale and lease option of real estate.

In most states, leases for a fixed term must be in writing, and if the term is greater than one year, the landlord’s signature must be notarized. If the lease is for a periodic tenancy (month to month tenancy for example), the law does not usually require a written contract. The exception to this would be when the period is greater than a year.
Even if a written lease is not required by state law, it is a sound practice to always have a written contract so that there is no confusion regarding the terms of the lease and intentions of the parties.

**Assignment and Novation**

**Assignment** - an assignment of a contract is when the interests of the original party (the assignor) are transferred to another party (the assignee). In general, an assignment will be permitted unless there is an express prohibition against assignment in the contract. The new party, (the assignee) assumes primary responsibility for the performance of the contract, and the original party (the assignor) incurs secondary responsibility for the contract.

Certain contracts cannot be assigned since an assignment cannot have any effect on the duties of the other party to the contract, nor can it reduce the possibility of the other party receiving full performance of the same quality. An example of this would be a contract between a patient and a doctor who specializes in a certain field of medicine. The doctor could not assign his contract to another doctor, as it could be detrimental to the patient. This is in contrast to Novation.

**Novation** – in the first instance, novation is the substitution of a new party into a contract. The original party is relieved of any obligation for the contract. Novation can also be the substitution of original contractual terms for new terms if both parties agree to the new terms.

**Appropriate Circumstances to Seek the Assistance of Your Broker When Writing a Purchase and Sale Agreement**

You should seek the advice or assistance from your broker anytime you feel that you or the brokerage may be at risk. If you are at risk, most likely your brokerage will be at risk as well. Designated brokers and managing brokers are responsible for the overall supervision and actions of their licensees. The term is referred to as **vicarious liability** which means that a party (the brokerage) is responsible for the actions of another party (the licensee).

While this list is certainly not exhaustive, the following are some key circumstances when you should consider seeking assistance:

- Unfamiliarity with a specific form
• Not knowing which form to use in which circumstance
• Unfamiliarity with new or existing real estate laws or legislation
• Problems revolving around communications with the purchaser
• If you are a new licensee
• If the purchaser is requesting contingencies which are unique or ambiguous
• If there is not a preprinted form available to cover a particular circumstance (we will be covering this in greater detail further in this chapter)
• If there is confusion with agency and who you should represent.
• Unique circumstances and unique properties
• Not knowing which addenda should be used in conjunction with a particular offer and particular circumstances
• If you have questions about the handling of the earnest money
• If you are unsure about the computation of time as it relates to the contingencies in the contract.
• If the potential purchasers have questions about the Purchase and Sale Agreement (PSA) that you cannot answer.

**HINT:** When discussing the details or issues of a transaction with your broker, always let your broker know early in the conversation if you are representing the buyer, seller or both. This will assist your broker in understanding the role of each party and the inherent liabilities to you and to the brokerage.

**“Unauthorized Practice of Law” by a Licensee and When a Client Should Seek Legal Advice**

A broker should avoid drafting contracts, contract provisions, or legal documents that could be construed as the product of an unlicensed standard form. Also, refrain from drafting custom agreements.

Use only standard forms in the exercise of your duties. Such forms must be reviewed and approved by real estate attorneys. Use extreme caution in adding anything to these standard forms.
In *Cultum v. Heritage House Realtors*, the court ruled that licensees need to take great care in writing real estate contracts, use standardized forms and ensure that all additions/addendums are in line with the terms and conditions of the contract, or the licensee can be held liable to for damages and losses.

According to the ruling:

“[An agent] is permitted to complete simple printed standardized real estate forms, which forms must be approved by a lawyer, it being understood that these forms shall not be used for other than simple real estate transactions which arise in the usual course of the [agent’s] business and that such forms will be used only in connection with real estate transactions actually handled by such [agent] as [an agent] and then without charge for the simple service of completing the form.”

**NOTE:** Many brokerages have polices which strictly prohibit licensees from writing in additional clauses in the contract without management approval. As a licensee, it is imperative that you understand your brokerage’s policies regarding this.

**Check for Understanding Question:**

You are writing up a Purchase and Sale Agreement for your buyer client. Your client may be exposed to a pay cut or lay off due to some union negotiations. Conversely, he may be eligible for a promotion and a pay increase depending on the union settlement. Your client has written three very detailed paragraphs on this situation and would like it to be a contingency to the contract so that he may not be bound to complete the purchase if certain circumstances should arise. He would like this verbiage to be added to the standard form as an addendum. As the buyer’s broker, what is the best course of action that you can take?

A. Encourage the buyer to have their attorney review the Purchase and Sales Agreement and the verbiage that he would like to include

B. Attach a copy of your client’s hand written contingency to the contract and label it Exhibit “A”

C. Rewrite the contingency into the body of the contract

D. Submit the offer to the seller without the contingency and without the buyer’s knowledge

The correct answer is A.

As a licensee, you are prohibited from giving tax or legal advice. As such, any time an issue arises regarding these matters, you should advise your client to seek professional advice.
When Your Client Should Seek Legal Advice

The following is a list, while not exhaustive, of some circumstances when you may suggest that your client seek legal advice:

- When your managing broker or designated broker suggests that it is necessary
- When there are serious misunderstandings or issues between buyer and seller
- When any party to the transaction is threatening a lawsuit
- When the issue involves serious legal ramifications
- When either party breaches the contract
- If you suspect fraud, negligence, misrepresentation or concealment is involved
- When any serious complications arise which are beyond your scope of knowledge
- When there is an unusual circumstance where a buyer may want to include certain verbiage in a contract
- When your client is at serious legal risk
- When you and your brokerage are legally at risk
- When an important major mistake has been made and needs to be rectified
- When a client breaches a contract
- When major complications arise from the title of a property
- When the offer requires additional written language which is beyond the frame work of the preprinted forms

**NOTE:** It is very important to seek the advice of an attorney, who specializes in real estate matters, and not an attorney who practices in any other specialty of law.

**TIP:** Ask the attorney to do a “Conflict of Interest” check as soon as possible to determine if there is any conflict with this attorney being able to represent you. A conflict of interest can arise when the attorney has had any dealings with the opposing party or may have even represented the opposing party in the past.

Check your understanding

Use this link to open a short quiz:
https://www.bookwidgets.com/play/GRQJW