Commercial Real Estate Practice Manual: Contracts of Purchase and Sale

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Introduction

The most important part of a real estate transaction is the contract of purchase and sale. It is the “road map” of the entire transaction. A properly negotiated contract will eliminate most problems between the parties as the transaction proceeds toward the closing and the transfer of title. The contract may be “bilateral,” having both parties bound to the contractual provisions, or “unilateral,” in reality an option, having one party bound to perform, with a binding contract coming into existence if and when the other party elects to be bound at a later date.

Letters of Intent

The agreement between the parties could begin with a Letter of Intent. A Letter of Intent is defined as a preliminary agreement that states the principal terms for a final written agreement. The parties may or may not intend to have the terms binding, depending on the circumstances. Courts are reluctant to find a binding agreement from a preliminary agreement and usually state that they are unenforceable, as it is merely an “agreement to agree.” However, if the Letter of Intent contains the essential terms and the parties viewed the signing of a formal contract as a “convenient memorial,” the courts have declared that the Letter of Intent is a binding agreement. It has been held that even though
the Letter of Intent is not binding but merely an agreement to agree, the parties must use their best efforts and negotiate in good faith. Letters of Intent have been upheld under the theory of promissory estoppel when a party takes some action—e.g., selling a building—in reliance on the good-faith negotiations of the other party before a formal agreement is signed. Therefore, the parties should make it very clear in the Letter of Intent as to any provisions that are to be considered binding upon the parties, that there are other matters that must be agreed upon that could limit some of the matters set forth in the Letter of Intent, whether either party may withdraw from the negotiations at any time, and what the final date is by which a formal agreement must be signed.

**Bilateral Contract Requirements**

The validity and enforceability of any contract depends upon certain requirements being met. Whether a contract is made depends upon the intention of the parties. The principal requirements to be met are:

**Offer**

There must be an offer to sell or buy. The offer must be specific as to the property involved, the purchase price, the time of closing, and the special conditions.

The only one who may accept an offer is the person to whom it is given. If seller makes an offer to A to sell real property for a certain price, B cannot accept the offer and claim that it is a binding contract. If an offeror dies or becomes insane, the offer terminates.

**Acceptance**

The offer must be accepted and the acceptance must be on "all fours" with the offer (the "mirror image rule"). Any acceptance that varies from the offer is a counteroffer and not an acceptance. Any counteroffer must be accepted before there is a binding contract. If the offer is to be accepted by a certain time, the acceptance after that time is not effective.

**Consideration**

Unless there is consideration passing from one party to the other, the contract is not binding. The consideration might confer a benefit to one party or might be a detriment to a party. The consideration can be a promise for an act, a promise for a promise,
an act for an act, or a cash consideration for promise or act.\textsuperscript{12}

Upon signing the contract, a check should be acceptable for the down payment. However, at closing, the seller should require a bank check, certified check, or immediate funds (wire transfer of funds).

\textbf{Legality}

The subject matter of the contract must be legal. For instance, a gambling contract is not enforceable in many states where law prohibits gambling.

\textbf{Capacity of the Parties}

If a party has been declared mentally incompetent or is an infant,\textsuperscript{13} the party cannot enter into a binding contract. In such cases, it is said that the party lacks the capacity to contract. Any contract by a party lacking capacity is void. If a party is mentally incompetent but has not been adjudicated an incompetent, the contract is voidable depending on the mental attitude of the person at the time the contract was executed. A corporation, partnership, or other entity may have to be qualified to do business and must have authority pursuant to a corporate resolution,\textsuperscript{14} partnership certificate, or trust agreement. An agent must have authority from the principal or have a valid power of attorney.

\textbf{Writing}

In order to have an enforceable contract for an interest in real estate, the contract must satisfy the statute of frauds. Contracts for an interest in real property must be in writing and signed by the party to be charged.\textsuperscript{15} The writing must contain the principal elements of the contract—namely, the names of the parties, the description of the property, the consideration, and the closing date. Part performance could eliminate the requirement of the writing and of the agreement complying with the statute of frauds.\textsuperscript{16}

\textbf{Form of Contract}

The contract may be a long formal agreement with a detailed description of the transaction, many conditions precedent to closing, and the procedure for the closing. The contract could be a one-page sheet of paper with the basic facts necessary to satisfy the statute of frauds. On the other hand, it could be a series of letters that, when taken together in their entirety, amount to a contract, satisfying the statute of frauds.
Matters Requiring Attention

When preparing a formal contract, the following matters must be given consideration.

"Whereas" Clauses or "Recitals"

The parties may want to explain the entire transaction at the beginning by using "whereas" provisions, which means the parties admit the correctness and truth of everything stated in the "whereas" clauses. It may be preferable to have a short one- or two-sentence "recital" telling about the transaction. The better way would be to avoid either "whereas" clauses or "recitals" and let the each contract provision "speak for itself" as to the transaction.

Parties

A party could enter into the agreement in its own name or in the name of a nominee or agent. The capacity of the party should be determined. If a married person is selling real property, the buyer in many states should require the signature of the spouse in order to know that there will be a contractual obligation to release of dower rights. It would depend on state law as to whether dower rights attach during the life of both parties. If dower attaches during the life of both parties, both husband and wife must sign any contract and deed conveying an interest in real property.

If the person signing is a partner of a partnership, a member of a limited liability company, an officer of a corporation or a trustee of a trust, the other party should require proof of the person’s authority to bind the party. This proof could be a resolution, a copy of the trust agreement, formation agreement, or by-laws. In Ohio, a trustee may hold property, and if no trust agreement is identified, any party is protected in dealing with the trustee without inquiring into the trustee’s authority.

The capacity of the parties should be considered. Without proper capacity, there would not be an enforceable contract. It is good practice to have the addresses of the parties in the contract.

Premises

The property that should be included in the sale must be clearly and completely identified. When possible, a legal description of the real property should be incorporated into the contract. The site should be examined to determine any other property that must be included. For instance, are there any ingress, egress, or parking
easements required? Are utility easements across adjoining properties required to operate the improvements on the real property? Is any personal property to be included, such as furniture in the lobby, room furniture, restaurant equipment, reservation systems and the like (for hotels); leases (for apartment or office buildings or shopping centers); overhead cranes and movable loading docks (for warehouses); or custom cabinets, drapes and curtains, wall-to-wall carpeting or chandeliers (in a residential transaction)?

**Deed**

It is wise to specify the type of deed that the seller should deliver to the buyer at closing. A deed could have the seller warrant title from the beginning of time, warrant the state of title while the seller held title, or contain no warranties. There are four principal forms of deeds:

1. **General Warranty Deed**—This deed contains the general warranty covenants. It is the type of deed usually requested by the buyer, since the seller warrants title from the beginning of time.

2. **Limited Warranty Deed**—This form of deed is referred to in some states as a “Special Warranty Deed” or as a “Bargain and Sale Deed with Covenants Against the Grantor’s Acts,” and contains the limited warranty covenants. The seller prefers this type of deed, since the seller only warrants that he did nothing to affect the title.

3. **Fiduciary Deed**—This deed usually is given by executors, administrators, guardians, trustees, receivers, and commissioners or sheriffs. The deed has the force and effect of a deed in fee simple. There are no covenants or representations as to the status of title.

4. **Quit-Claim Deed**—This deed has the force and effect of a deed in fee simple, but there are no covenants or representations.

**“As Is”**

Many times the seller has a provision in the contract that the premises are being sold “as is,” meaning that the seller is not making any representations as to the condition of the property. This will not protect the seller against any fraudulent misrepresentations or fraudulent concealment of a fact. The buyer, to protect himself, should provide that he has the right for a period of 10 days (or longer, if necessary) after the signing of the contract by both parties to inspect the property or have an engineer inspect it.
**Purchase Price**

The entire purchase price should be stated. The contract could provide that a portion of the purchase price is for the land, another portion is for the building and improvements, and the balance is for the personal property. The allocation of the purchase price could be important when determining the amount of any transfer tax imposed for the sale of real property. By allocating a certain amount to the personal property, considerable savings of transfer tax could result.

**Mortgage Financing**

If the buyer needs a mortgage loan to close the transaction, the buyer should require that the obligations under the contract are contingent upon getting a mortgage loan commitment within a certain period of time. The buyer should specify the minimum amount of a loan needed, the maximum interest rate, and the shortest term acceptable for the loan. By doing this, the buyer will not be forced to accept a loan with unaffordable payments. The seller will want the buyer to diligently pursue the loan application and to furnish some evidence that the loan is obtained; otherwise, the seller has the right to terminate the contract.\(^\text{31}\)

**Closing**

There should be a definite time and place fixed for the closing and transfer of title. There may be a provision that the parties may agree on a different time and place if all conditions are satisfied before the scheduled closing date. Without a definite date, time and place, it would be difficult for a seller to prove that it tendered the deed at the scheduled closing time as provided in the contract and the buyer did not accept it. In order to have a valid tender, the deed must be executed, witnessed and acknowledged, and offered with the proper amount for the conveyancing fee required by the County Auditor.

**Title Insurance and Survey**

The buyer of real property must have the title examined to ascertain the proper owners of the real property, any liens that may encumber the property, and other encumbrances against the title, such as reservations, reversions, easements, leases, or options to purchase or to lease. Depending on the location of the property, the title examination could be done by a title insurance company that would issue a title report or a title commitment or by an attorney who would give an attorney’s opinion of title. In addition to the title examination, it is customary in most areas to
obtain a survey of the real property in accordance with the most current ALTA/ACSM Minimum Standard Detailed Requirements for Land Title Surveys. The survey should:

a. Be certified by a registered surveyor;
b. Include a legal description on the survey print so it may be compared to the outline of the property drawn by the surveyor;
c. Show the beginning point of the legal description as well as the distance to the nearest cross street or corner;
d. Indicate the location and dimension of all improvements on the real property;
e. Show any encroachments on the particular parcel or on the adjoining parcels;
f. Show any set-back or side-line violations;
g. Show the location of all utility easements and easements held by others, such as a driveway easement;
h. Indicate the parking areas and the number of parking spaces available;
i. Show ways of ingress and egress to public streets, including curb cuts;
j. Show whether any portion of the property is in the flood plain; and
k. Contain a certification by the surveyor that the survey is true and correct and made from actual field measurements.

Adjustments

It is important to specify the expenses that will be apportioned at closing. These adjustments could be for real estate taxes, assessments, insurance, rents, security deposits and even closing expenses, such as title examination and title policy, survey costs, conveyancing fees, and recording charges. Many times the buyer will insist on all assessments being paid in full. If they are scheduled to be paid in annual installments over a specified period of time, the buyer sometimes will adjust the annual payment and will agree to pay the future installments over the specified period of time.

In many states, the real property owner may be given a reduced tax levy if the property is being used for agricultural purposes or if there was some other tax abatement available for the property. In such cases, if the property will be used for other purposes or if the abatement ends upon transfer, the state may want to recoup some of the abated taxes. This would require an adjustment between
seller and buyer or would require an agreement between buyer and seller that seller would pay any amounts demanded by the taxing authority.

Very often the buyer will not agree to adjust the insurance premiums. The buyer will want to personally obtain insurance and have the seller cancel the existing policy. The seller in such case will incur a slight loss on the cancellation, since insurance companies always have a “short rate” cancellation computation.

The buyer will require the seller to obtain a final reading of all utilities and to pay all amounts due to date of closing. If the amounts cannot be obtained at time of closing, the buyer may require that an amount be put in escrow to ensure payment.

**Representations**
There are many representations that buyers would request from sellers. Among them are:

a. That the seller has the requisite authority to execute the contract and the deed;

b. That no work was done on the property in the time period within which mechanic's liens may be filed or, if new construction, that there are no mechanic's liens on or which could attach to the property;

c. That all permits have been obtained and there are no building or zoning violations;

d. That all financial statements and the rent roll furnished to buyer are true and correct;

e. That the improvements are free of defects and habitable and that seller guarantees it for one year after closing. In Ohio, there is an implied warranty of habitability for residential properties; and

f. That there are no environmental problems or hazardous substances on the property.

**Conditions Precedent**
Depending on the particular real property, the buyer will want to examine many items before becoming obligated to take title to the real property. The examination should include the following:

a. A thorough inspection of the real property to ascertain its condition. This usually is performed by an engineer to determine
the structural soundness of the improvements.

b. An inspection to determine whether there are any termites or other pest infestation and whether any damage was done by them.

c. An inspection to determine any environmental problems, such as asbestos, underground tanks, gas or oil wells, ground contamination and the like.

d. A review of all permits to ascertain that they are and will remain in full force and effect, including, without limitation, variances, building permits, occupancy permits and signage permits.

e. A determination of whether the property has direct access to public roadways and adequate utilities with the necessary capacity to operate the buildings as intended.

f. Assurance of an acceptable title search and survey and approved mortgage financing.

g. If rental property, a review of all leases to be certain that they are acceptable and do not contain any purchase options.

h. Assurance that estoppel letters have been acquired from all tenants.

i. An acceptable rent roll showing the status of each tenant, space occupied, rental amounts, any defaults, and termination dates.

j. Letters from seller addressed to tenants advising them of transfer of ownership.

k. Assurance that all seller’s representations and warranties are true when made and shall be true and correct at closing.

Giving the buyer too many ways to terminate the contract due to a failure of one or more conditions, or permitting the buyer to terminate the contract with only a forfeiture of the down payment (or even giving the down payment back to the buyer) if the conditions are not satisfied, can weaken the force of the contract and lead to a court determination that the contract is merely an option to purchase or an offer to sell.37

**Escrow Instructions**

If an escrow agent will be used to handle the closing, specific instructions should be set forth as to the agent’s responsibilities and the time frame for delivering documents and funds. The parties should require that copies of all documents given to the escrow agent should be furnished to the other party for review at least three or four business days prior to the closing. The escrow agent should be instructed as to who should receive the various documents after the closing and transfer of title.
Miscellaneous Provisions
Following are other important provisions that should appear in all contracts:

a. A provision setting forth where notices should be sent, by what means and when they are effective.
b. A provision that the buyer can terminate the agreement or accept insurance proceeds and take title in the event a fire occurs.
c. Delivery of keys, combination of locks, guaranties, plans and specifications for improvements, permits, and personal property to buyer at closing.
d. Certification that real property is not agricultural land within the meaning of the Agricultural Foreign Investment Disclosure Act of 1978 and that the seller is not a foreign person within the meaning of the Act.
e. Certification that the seller is not a “non-resident alien,” “foreign corporation,” “foreign partnership,” or “foreign estate” within the meaning of the Internal Revenue Code of 1986, as amended from time to time.
f. A provision that the agreement contains the entire agreement and that no other verbal or side agreements exist that are not incorporated in the written agreement.
g. A provision that the parties and their respective heirs, executors, administrators, personal representatives, successors and assigns are bound by the agreement.
h. A statement that there is no real estate broker, or if there is one, name of the person and designation of the party responsible for the broker’s fee. Further, an acknowledgment should be added that neither party has dealt with any other broker, and that if a claim is made by a broker other than the one named in the agreement, the person who dealt with the other broker will be responsible for any fee and will hold the other party harmless.

Execution
Both parties should sign the agreement in order to be bound as required by the statute of frauds. The buyer should require that each signature of the seller be effected in accordance with the state’s recording and conveyancing laws so that the buyer is able to record the agreement; thereby limiting the ability of the seller to attempt to sell the real property to a third party while the agreement with the buyer is in effect. The seller does not like the contract recorded because it may be difficult to remove it from the record if the buyer defaults. When recording any document encumbering real property, one must be careful not to commit a
slander of title. An improper filing could give rise to an action for damages.\textsuperscript{39}

\textbf{Mistake—Basis for Termination}

\textbf{Mutual Mistake of Fact}

If one party is talking about real property owned by seller on A Street and the other party is talking about real property owned by seller on B Street, there is no meeting of the minds, meaning no contract exists. In this case, the contract is unenforceable and can be terminated by either party.\textsuperscript{40} If both parties meant the property on A Street but in the contract described the property on B Street, the court would reform the contract to express the intention of the parties.\textsuperscript{41}

\textbf{Mistake as to the Subject Matter}

If the parties negotiate with respect to a specific property but, unbeknownst to the parties, the entire property was destroyed before negotiations began, the contract would be void.\textsuperscript{42}

\textbf{Mistake by One Party}

If a seller asks $50 for an article and a buyer in good faith agrees to pay it, the seller cannot get out of contract if he later discovers that the true value of the article is $250. A mistake by seller in a mathematical computation of an estimate accepted by the buyer is no reason for termination of the contract.\textsuperscript{43}

\textbf{Tortious Interference}

To recover on a claim of tortious interference with a contract, a plaintiff must prove all of the following elements:

1. The existence of the contract;
2. The defendant’s knowledge that the contract existed;
3. The defendant’s intentional procurement of breach of that contract;
4. The defendant’s lack of justification for the procurement of the breach of contract; and
5. The damages that resulted from the breach.

If a defendant’s interference with the contract is justified, such as being the attorney for the party terminating the contract, then the
interference is not actionable. Only improper interference is actionable.44

Endnotes


8. Frith v. Lawrence, 1 Paige (N.Y.) 434.


17. In Ohio, persons under the age of 18 years are infants. See Ohio Rev. Code § 3109.01. An infant may disaffirm a contract when attaining the age of 18 years. However, infants who misrepresent their age may be prohibited from disaffirming. See Real Property Law and Practice, 3d ed., § 15-11C.


21. Ohio Rev. Code §§ 1339.04 (repealed), 5301.03.

22. Ohio Rev. Code § 5302.05.

23. Ohio Rev. Code § 5302.06.


25. Id.


27. Ohio Rev. Code § 5302.11.


34. Ohio Rev. Code §§ 5713.30 et seq.


38. 7 U.S.C. § 3501 et seq.

39. See discussion of law relating to slander of title in Sections 152 through 157, Jur. 3d.


44. Andrews v. Carmody, 145 App. 3d 27 (Ct. App. 11th Dist.).