

CHAPTER 04

CONTRACT ISSUES

Learning Objectives

After this chapter, you will be able to

- Identify the revisions to the One to Four Family Residential Contract (Resale).
- Identify the key changes to revised TREC addenda.
- Understand that the Effective Date should be filled in every time in every contract and who should complete that date.



Changes to Promulgated Forms

While more substantial changes were proposed in 2019, at its November 2019 meeting, the Commission accepted the Broker Lawyer Committee's recommendation to withdraw all proposed amendments with two exceptions. These exceptions included changes to the Third Party Financing Addendum and the Addendum for Authorizing Hydrostatic Testing.

* The Third Party Financing Addendum is amended to clarify that the three-day notice requirement in does not apply to Paragraph 4 and the "time is of the essence" language was moved to the body of Paragraph 2 for clarity.

* The Addendum for Authorizing Hydrostatic Testing is amended to include a reference to the scope of hydrostatic testing in the top sentence.

AND, as a reminder to those who took the last Legal Update courses early in the cycle:

Notice of Buyer's Termination of Contract (effective March 1, 2019)

Changes include:

- * New requirements when the election to terminate is due a lender's determination that the property condition is not satisfactory;
- * Option to terminate under the Addendum Concerning Right to Terminate Due to Lender's Appraisal;
- * Option to terminate under paragraph 6.D. when objections to title or survey are not timely cured.

Notice of Seller's Termination of Contract (effective August 13, 2018)

A new notice was adopted for sellers to use to give notice of termination under rights granted under the mandatory contract forms or addenda (see revised Paragraph 5).

Third Party Financing Addendum (effective March 1, 2019)

Clarifying revisions were made to this addendum in Paragraph 2B, Property Approval, to include a timeframe for buyer to give seller notice and evidence of the lender's determination regarding the loan due to property condition.

Settlement statements were added to the authorization to release information paragraph. It was also reformatted to be consistent with other Commission promulgated addenda.

One to Four Family Residential Contract (Resale)

PARAGRAPH 2

Paragraph 2 is still evolving because of the way we live today and the SMART home. Paragraph 2 talks about **IMPROVEMENTS (2B) PERMANENTLY INSTALLED and BUILT IN ITEMS and ACCESSORIES (2C)** - these things should remain with the property. How is it determined if it stays? We first must understand the legal tests of a fixture (real property) versus personal property. The main question is what was the intent of installation? Was it meant to remain permanently or to be removable in the future?

The courts use the **"TRIPLE A"** method:

Annexation – can it be removed without causing damage?

Adaptation – is it customized for the property or is it standard?

Agreement – what was their intention?

Before an agent lists a property, the agent should ask the seller if they intend to leave certain items or if they will be removing them. If removing them, the agent should list those items on **2D EXCLUSIONS**. The agent could take page 1 of the contract and highlight paragraph 2 as a talking point. Many issues that come up today relate to décor and tech items sellers want to take to the new property. An agent must work out how this property will be handled. A best practice is to replace or remove the item before the house is shown to prospective buyers so a buyer does not assume it will stay. If the property is too large or the seller has no place to store it, like an antique chandelier, the agent should make sure to call it to the buyer's attention during their tour of the house that the item will not stay. When EXCLUSIONS exist, there are three times they need to be included in the transaction: on the listing agreement, in the MLS, and on the contract. ***If it is NOT in the contract - it will NOT happen.*** When touring the home with the buyer and the buyer wants an item, the agent should make sure to clarify if it will stay with the house. The agent can utilize the NON REALTY ITEM ADDENDUM (TREC OP-M) and attach pictures for clarity. Alternatively, if the MLS remarks state, "seller will leave washer and dryer" it will need to go on a NON-REALTY ITEM ADDENDUM. Without the addendum, the seller may assume the buyer does not want the items. For clarity, everything needs to be in writing and not assumed. Agents have a responsibility to make sure the client's wishes are followed. Note that most of the items listed in paragraph 2 came from previous court cases.

There are many examples of property that require clarification as to whether they will stay with the house.

Outdoor kitchen items are a good example. A grill may be removable or easily unhooked and detached, same with a small fridge or wine fridge. While the items may leave an open space, the agent needs to determine whether these items will go or stay. Garage décor cabinets are another example because they could stay or be removed. The buyer may be thinking this will be great for storage only to find upon move-in the cabinets are gone. Consider the rose bush the seller's grandkids gave to her every Mother's Day – she is not going to leave those! Yet according to paragraph 2, they stay. The fruit trees that the buyer thought would be great for canning and holiday goodies could be replaced with a regular tree. Similarly, the seller could replace the entry door keyless lock with a KwikSet lock. The door with the doggie entrance just the right size for the buyer's dog may be replaced with a regular screen door. The pool sweep, nets and brushes the seller just bought can be used at their new home, so the seller took them. Yes, these have really happened!

Smart Homes

With new technology comes new issues. The agent should ask the sellers if they will be leaving their home technology devices. Items to consider include smart doorbells, keyless entry, garage openers, alarms, camera systems, thermostats, speakers (Alexa, Google Home etc.), appliances, robot vacuums and items that are installed like outlets, switches, and lighting (bulbs too).

Many things work with a HUB feature appliance and if taken – nothing works. The agent should include a seller checklist for move out and a buyer checklist for move in as a reminder. Remember that these devices collect data - **YOUR CLIENT'S DATA** - and the agent should have their client "consciously uncouple" from them. These devices should be set to factory settings prior to move out. Remember, if the seller leaves the Smart TV as a "gift" their information may be held in the Netflix or Amazon Prime features. Don't let a client's data get used to purchase movies for the new buyer. Many devices can be operated remotely and if the seller still controls the device, the new buyer may be in for a surprise. These conversations will alleviate any misunderstandings, putting everyone on notice regarding what needs to stay for functionality. It's all about disclosure and setting expectations. (Remember paragraph 2.)

If inspectors will need access to these systems, make arrangements for them to have access.

Paragraph 6, Objections:

This paragraph frequently includes redundant references to "sole residence" or "single family residential use." That is a given as the form is named the "ONE

TO FOUR FAMILY RESIDENTIAL Contract." This blank can be used for so much more to protect the client. The agent should ask the buyers, "What do you plan to do, add, have, bring or run out of this property?" For example, the buyer desires to have an amazing in-ground gunite pool with a cove and swim-up bar. A particular home and lot seem to be perfect. The survey comes back showing that right down the middle of the lot is a gas line that will prevent any digging. Will this keep the buyer from buying? YES, it is the buyer's desire to have the pool and the pool will not be able to be built on the lot. This would give the buyer an out of the contract. The contract states, **"Buyer may object in writing to defects, exceptions, or encumbrances to the title: disclosed on the survey other than items 6A(1) through (7) above; disclosed in the Commitment other than items 6A(1) through (9) above; or which prohibit the following use or activity:_____."** That blank gives the buyer opportunity to object if the client wants to **add** a structure or pool, **have an** exotic pet or raise chickens, **bring** their RV or big truck to the property, **run** a day care, beauty shop or group home, and that use or activity would be prohibited. What does the investor **do** with purchased property—he rents it! SO, this blank allows the stipulation that they can do as they desire with the property. Examples of descriptions could include "in-ground gunite pool" or "raise chickens," "potbelly pig pet," "RV on property," "day care," or **"IMMEDIATE rental occupancy."** Consider grandfathering, as well – perhaps it is okay for this owner to have horses, but the next will not be allowed, so one might consider adding "horses allowed on the property."

The second part to the paragraph relates to the time-frame to object. The contract states, **"Buyer must object the earlier of (i) the Closing date or (ii) ___ days after the Buyer receives the Commitment, Exception Documents, and the survey. Buyer's failure to object within the time allowed will constitute a waiver of Buyer's right to object; except that the requirements in Schedule C of the Commitment are not waived by Buyer."**

The third part to the paragraph relates to the seller's duties after a written objection. The contract states, **"Provided Seller is not obligated to incur any expense, Seller shall cure any timely objections of the buyer OR third-party lender within 15 days after the Seller receives the objections (CURE PERIOD) and the Closing Date will be extended as necessary."**

The fourth part to this paragraph relates to the buyer's decision and states, **"If objections are not cured within the Cure Period, Buyer may, by delivering written notice to the Seller within 5 days after the end of the Cure Period: (i) terminate this contract and the earnest**

money will be refunded to Buyer; or (ii) waive the objections. If Buyer does not terminate within the time required Buyer shall be deemed to have waived the objections."

The fifth part of this paragraph discusses new discovery or changes, and states, ***"If the Commitment or Survey is revised or any new Exception Document(s) is delivered, Buyer may object to any new matter revealed in the revised Commitment, Survey or new Exception Document(s) within the same time stated in this paragraph to make objections beginning when the revised Commitment, Survey or Exception Document(s) is delivered to the Buyer."***

The agent should have documentation for the buyer to view, and there is a 15-day **CURE PERIOD** with a 5-day decision period. If new documentation comes in, the buyer has the same number of days to object to the new item.

Cure Period Example

A title commitment is issued with an exception to a deed restriction that prohibits having farm animals on the property. The buyer has specifically noted under paragraph 6D that he wants to raise chickens in the backyard. The buyer timely objects to the deed restriction. Timeframes start running for this particular objection.

Ten days later, the commitment is revised with an exception that fences are off the property line as shown on the survey. The buyer timely objects to the exception as to fences being off the property line. The seller has the surveyor come back out to the property and the survey is revised to show the fences are not off the property line. The exception is removed from the title commitment within the 15-day cure period.

The buyer terminates the contract within 5 days of receipt of the revised commitment because the objection to the deed restriction had not been cured. The buyer has waived the objection to the deed restriction because the buyer did not terminate the contract within 20 days of the objection to the deed restriction.

Effective Date

What do you do if you get a contract back with no Effective Date, do you still have a valid contract? The answer is YES you do, BUT it may take a judge to define

TREC Case Study 1

Buddy Is Going to Love This!

Keller TX - A woman hires an agent to help her move to Texas from out of state. During her fly-in home tour, she continually remarks, "Buddy will love this! This will be Buddy's room, Buddy will love this yard." Even a mediocre agent would have asked her, "What? Right, who is Buddy?" But the agent did not ask.

The buyer finds a great home and puts in an offer. It soon closes and she moves in. One evening she comes home to find Buddy is no longer there. She rushes outside and calls his name frantically. Neighbors rush to see if they can help. They ask, "What's wrong, what's happened?" She begins to tell them that she has lost Buddy and must find him! They begin to ask for a description. "What does he look like? What was he wearing?" She replies "Oh he's about this tall and he has black hair, spots and the cutest pink nose and ears and..." Suddenly, she is interrupted by a neighbor who asks "Is he a PIG?" The other neighbors are shocked at her outburst when the buyer replies, "YES, he is! He's my potbelly pig- I've had him for 5 years and he is like my soul mate! Have you seen him?" The woman smiles and replies, "YES, I HAVE, I know exactly where Buddy is, he's at animal control. I had him picked up. Didn't anyone tell you that you can't have swine in the city limits!?" Mortified she runs in the house – who do you think she called first? NO, it was to animal control, she must bust her soul mate out of animal jail first! The NEXT call was to her agent. If only she had put "Buddy- potbelly pig" in paragraph 6. The buyer would have known and could have made an informed decision about whether to give up her soul mate or look for another home.

The moral of the story: Don't be that agent! Ask questions and protect your client!

the starting time for all the deadlines in the contract and their performance timelines. The rule is after acceptance and notification, the last broker who touches it fills in the Effective Date. The Effective Date is the date of final acceptance of all parties.

There are four elements that must be satisfied for final acceptance to take place:

1. The final contract must be in writing;
2. The buyer and seller must sign the final contract,

including the initialing of any changes to the initially drafted offer, if applicable;

3. Acceptance must be unequivocal;
4. The last party to accept must communicate acceptance back to the other party or the other party's agent, if applicable.

The Effective Date is the date when the last element (communicating acceptance back) is completed after the other three elements are satisfied.

When you get the contract back and if the Effective Date has been left blank – fill it in using the date you were given notice it was accepted. Notify everyone you have done so and the date inserted. This way the timelines will be properly determined and followed to keep everyone on track in the transaction. Remember, the timelines are counted in **CALENDAR days** so the Effective Date is day 0 and the next day starts day 1 of your contract timelines.

Option Money

In the One to Four Contract, paragraph 23 is the termination option. It states that the buyer agrees to pay the seller a fee and must deliver it within 3 calendar days after the effective date. This gives the buyer the unrestricted right to terminate within the time frame agreed in the second blank by giving notice before 5pm on the last day. If the buyer fails to deliver the money, there is no option and cannot terminate under that paragraph. If the buyer does deliver the option money and terminates within the timeframe set out in the paragraph, the option money is kept by the seller, but the earnest money is refunded to the buyer. If there is no termination by the buyer, the option fee may be credited to the buyer at closing depending on which box is checked in the contract. **Time is of the essence** for compliance, and timelines must be faithfully followed! This also holds true if you are writing a backup offer. Remember if you never become primary, the option money is still retained by the seller.

When it comes to delivery, there seems to be some confusion. On page 10 of the contract, it plainly says the option fee receipt must be **signed by the Seller or Listing Broker**. Do not leave it at the title company, it is not for them to hold nor receipt. Your buyer or you may take it to the office of the listing broker, if their policy allows for receipt by the front desk. There may be a need to drive and meet the other broker somewhere to receipt and deliver. You or the buyer may need to deliver it to the seller directly and have them sign the receipted page. There are also some quick electronic methods of delivery – GoOptionPay™, Zelle®, Venmo, Zoccam® to name a few. Deliver it in a timely fashion to protect your client.

According to Rule §535.146(b)(3), “Unless a different time to deposit trust money is expressly agreed upon in writing by the principals to the transaction, any trust money received by the broker must be deposited in a trust account or delivered to an authorized escrow agent within a reasonable time, which the Commission has determined to be not later than the close of business of the second working day after the date the broker receives the trust money.”

Be responsible when it comes to the option money and its receipt.

Additional Option Period:

If the parties to the contract wish to extend the option period, TREC form 39-8, Amendment to Contract, should be used. The Amendment should be signed before the end of the original option period. Just as with the original option period, a fee must be paid for the additional option period for it to be effective. You should note that the Amendment form states that the additional option fee has been paid to the Seller. Make sure payment of the additional option fee takes place when the Amendment is signed. There is no time frame for future delivery.