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9/10/19 –Volume 1

Understanding Contracts: Paragraph 1

Contracts are a way of life in the real estate business. For most real estate professionals' paragraph 1 (parties) is the beginning. However, the reality is some basic housekeeping affords should be addressed prior to filling-in the form.

TREC promulgates six sales contracts for the public and license holders' use. Before drafting any contract, you should always check the right corner for the current date. Using an out of date contract could be considered unauthorized practice of law. Unfortunately, professionals using contract software can easily overlook and assume the system will automatically pull the current contract template. For example, if you are working with a past client, the last form used will be recalled, which may or may not be out of date. Normally when starting a new client template, the software will use the current form.

Of the six available contracts, there are two resale/used (1-4 family, Condo), two new (New Home Complete and Incomplete), and two land (Farm and Ranch, Unimproved) contracts. Just knowing the types of sales contacts isn't enough, knowing when to use the forms is critical to the transaction.

Examples:

1-4 Family contract is used for single dwellings, duplex, triplex, quadruplex and townhouses (when the land is owned fee simple and the dwelling).

Condo contract is used when selling a unit (paint to paint). The building has a legal description, not the unit. A survey is not required for a condo and no addendum for HOA is required. This information is located within the contract.

New Home Incomplete contract is used when the new home builder has not completed the construction of the dwelling.

New Home Complete contract is used when the new home builder has completed the construction, and no one has lived in the home.

Unimproved contract is used for a single-family vacant lot

Farm and Ranch contract would be used when selling acreage (Ag use), vacant, or improved, and when selling crops and/or livestock.

Prior to filling in paragraph 1, understand who the buyer(s) are and who has the authority to enter into the contract. Buyer(s) could be an individual, executor (will), administrator (without a will), corporation, LLC, partnership, life tenant or trust.

Examples:

Individual must be legally competent (18, Sane and Sober) with limited exceptions.

Corporation the officer must show proof of authority by providing a corporate resolution.

LLCs are formed by members. Only the managing member(s) has the authority.

Partnerships/ Limited Liability Partnership (LLP, LP) may have a general partner, or other legal forms allowing authority, or all partners must sign.

Life Tenants have the exclusive right of possession, management, and control of the property during the term of the measuring life, and have homestead rights. The life tenant also has the rights to any income or royalties they may produce, and sell or lease the property for the duration of the measuring life.

Trusts are made up of three parties. The Trustor (creator), Trustee (owns and manages the trust) and the Beneficiary (the one(s) that receives out of the trust. There are several types of trusts, Land, Living, Testamentary, Revocable, Irrevocable, Spendthrift, and Crummey Trust. The only party with authority to transfer out of the trust is the Trustee.

Common Types of Trusts:

Land Trust is a legal entity that takes ownership of or authority over, a piece of property. It is often used for privacy of the owner, to avoid probate and protect against judgements and liens.

Living Trust "inter vivos" can be a revocable (changed) or irrevocable (not changed) trust. This is a written document which, during the owner's lifetime, their assets are placed into a trust and then transferred by the Trustee to their named beneficiaries upon the owner's death. A Living Trust is used to avoid probate.

Testamentary Trust is created through a will, after death. This trust may be created to form a child's trust to name a designated trustee to manage property left to a minor.

Spendthrift Trust is created for the benefit of a person unable to control their spending. The trustee has full authority to make decisions as to how the trust funds may be spent by the beneficiary.

Crummey Trust (named after Clifford Crummey, the first taxpayer to use this technique in the 1960's) is part of an estate planning that may be used to take advantage of the yearly gift tax ($15,000) exclusion when transferring money or assets to another person.

In conclusion, Paragraph 1 is the first consideration in the contract (promise exchange for a promise) and the blueprint to the transaction. Performing these basic "housekeeping" practices could avoid issues in the future.