DRAFTING EXERCISE 7

Contract for the Purchase of a House

Two of your favorite clients, a brother and a sister in their 20s, have come to you for help with the sale of a beautiful lake shore cottage, which they have recently inherited and which had been in their family for three generations. Both the brother and the sister feel very sad about having to sell the cottage, but with their present incomes, they simply cannot afford maintenance and taxes on the cottage.

Having advertised the cottage for sale themselves, your clients have now found a potential buyer who seems suitable - a man who has just retired after forty years as a schoolteacher and who is in a position to pay cash for half of the sale price and borrow the rest of the money needed.

Your clients have asked you to draw up the necessary papers. While talking with them, you realize that each of them dreams of being able to buy the cottage back sometime. You ask them if they would like you to include a right of first refusal so that if the prospective buyer ever sells the cottage they would be given the first chance to buy it. They are delighted with that idea and ask you to include such a provision in the contract.

Draft a contract that your clients, the brother and the sister, can have any purchaser sign.

As you begin drafting this contract, you may want to check the Pointers for Drafting that follow.

POINTERS FOR DRAFTING A CONTRACT FOR THE PURCHASE OF A HOUSE

1. First, remember to set forth the names and addresses of the parties and how the buyers intend to take title (in fee simple absolute for one buyer, or as community property or tenants by the entirety for husband and wife in some states, or as joint tenants or tenants in common if there are to be multiple owners).

2. Specify the amount of the purchase price, the date of closing, and the form in which the money must be paid at closing - e.g., certified check.

3. Next, state how much has been paid as a deposit (called earnest money) at the time of signing the contract. Who is to hold the earnest money until closing? Is any interest to be paid on the money? If so, under what circumstances, and to whom? If the sale falls through, who is to get the earnest money - under what conditions? What if the parties disagree as to whose fault it was that the sale was not completed?

4. How long does the buyer have to secure financing? How soon must the buyer begin attempting to get financing? What is the maximum rate of interest that the buyer will be obligated, under this contract, to pay for financing? Are there any other limits on the type of financing that the buyer must seek - e.g., a 30-year mortgage with a fixed interest rate, an adjustable rate mortgage, a loan with balloon payments?

5. What happens if the buyer cannot get the approved type of financing within the stated time? Is the time extended? Or is the contract terminated? If the contract is terminated, how is the earnest money to be distributed?

6. Are there "emergency" termination provisions, with or without liquidated damages provisions, for unusual situations, such as loss of a job, transfer to another area, or winning the lottery? Who decides whether or not the emergency provisions should be put into effect?

7. What happens if any of the parties should die prior to closing?

8. What happens if the property is partially or completely destroyed prior to closing by fire, wind, storm, earthquake, or other event beyond the control of the parties? What if the damage could have been prevented or lessened by one of the parties? What if the damage was caused by one of the parties? Or by an agent or invitee of one of the parties?

9. Who carries insurance on the property between the time the contract is signed and the time of closing? How is that insurance to be applied in case of partial or total destruction of the property prior to closing? Does it matter what caused the destruction?

10. What if partial or total condemnation of the property is begun, or completed, prior to the time of closing?

11. What proof of good title must the seller make to the buyer, and by what time? Will there be an extension of time to allow the seller time to try to clear title? How long might that extension be?

12. What personal property is to stay with the house, and what property is to be removed? Watch for those emotionally important flagpoles, ugly lion statues, bird baths, plants, and so on.

13. Does the seller have a right of first refusal to re-purchase the property? If so, how long does the right last? How is it to be exercised? What happens if a sale takes place without compliance with the terms of the right of first refusal? What if there is condemnation of the property? Have you drafted the right of first refusal so that it does not violate the Rule Against Perpetuities (RAP)?

Remember that in order to comply with the RAP, a right of first refusal must either be limited so it is exercisable only within the lifetimes of specific, named person; or be limited so it is exercisable no later than twenty-one years after the date of the contract; or be limited so it is exercisable no later than twenty-one years after the death of some person or persons named in the contract as measuring lives.

14. Is it clear who will have the right to exercise the right of first refusal and how the purchase price under that right will be established?

Note: For the drafting problem in this section, you will have to be particularly careful to make it clear who is entitled to exercise the right of first refusal. Could either the brother or the sister exercise the right alone? What if both of them want to buy, but each refuses to cooperate with the other and insists on taking title in his or her name alone? What if the brother has died, and his son wants to buy back the family cottage? What if there is a conflict between several people entitled to exercise the right of first refusal?

15. Have you provided for some means of arbitration if a dispute arises under the terms of this contract?

D. THE CLOSING (OR CLOSE OF ESCROW)

1. Introduction

Basically, the closing is the time at which the buyer pays the money to the seller and the seller gives the buyer a deed to the land. It sounds simple. In fact, closing is one of the most complex and important times in a real estate transaction.

It is important that you, as a lawyer, understand what should happen at closing so that you will be able to protect your client. Many problems, if not caught at closing, will be considered to be "merged in the deed." That means that even though your client signed a contract requiring that a certain provision be included in the deed, if that provision somehow does not show up in