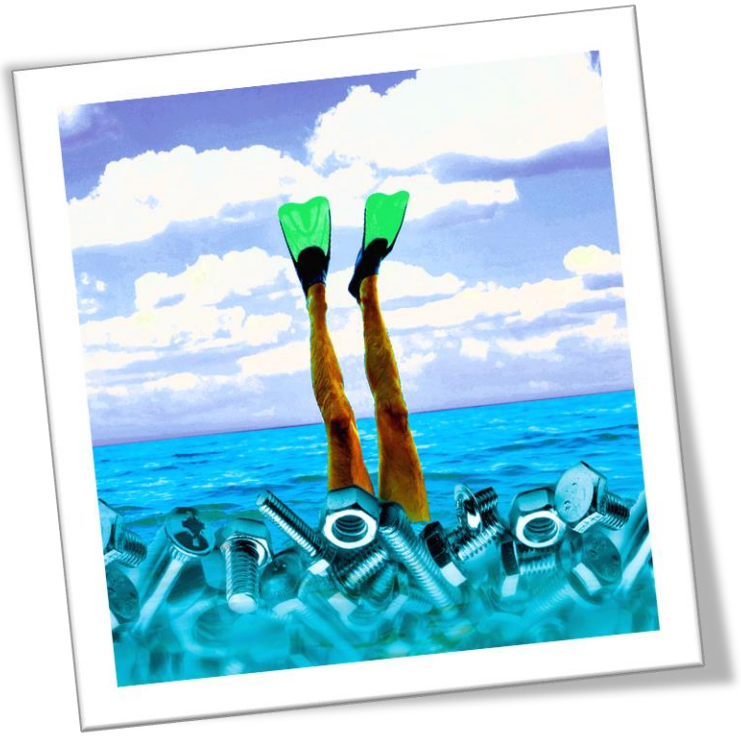
Dive into the Nuts and Bolts of Purchase and Sales Agreements



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Dive into the Nuts and Bolts of Purchase and Sales Agreements

This paper pretends to be a "made easy"-type of guide as it is drafted in a question-and-answer format. It touches on some recurrent provisions and issues common in drafting or review of real estate contracts, in no particular order of importance. This paper also assumes you have already identified and applied the governing law—i.e. those provided in Texas Local Government Code Chapters 253, 272, or whatever—and you're ready to start papering the deal.

Who produces those "fill in the blank" or "checkbox" contracts we sometimes receive from other parties?

In Texas, we often see one of the following types of promulgated forms come across our desks. Although they may seem alike if you don't see them regularly, there are major differences between the two:

Texas Realtors (TR) Forms

The Texas Realtors, or "TR," is a private, membership-only advocacy organization for realtors and private property rights. It publishes a series of forms which are only permitted to be used by TR members, and these forms will generally be introduced by one of the brokers on the other side of a proposed transaction. These can easily be identified by the red and blue logo at the top of the first page. When reviewing and proposing edits for clients, non-TR members would need to provide separate addendums or riders for revisions or to address matters not provided in the TR forms.

Texas Real Estate Commission (TREC) Forms

The Texas Real Estate Commission, or "TREC," is a state regulatory agency charged with, among other things, the interpretation and enforcement of the Texas Real Estate License Act (TRELA), as codified in Chapter 1101 of the Texas Occupations Code. TREC is also responsible for the regulation of licensing and education of real estate professionals (including real estate inspectors, right-of-way agents, real estate education providers, real estate brokers, and sales agents), and serves to protect the public by administering current law and adopting and enforcing new regulations governing real estate practice. TREC forms —purchase and sale agreements, leases, financing addendums, and others—are available to anyone, for free, on the TREC website. However, TREC forms are intended for use by licensed and trained real estate brokers or sales agents. These forms also have the black TREC logo at the top of the first page.

I'm not a member of TR and would rather just draft my own contract, anyway. What are the minimum requirements to include in a real estate purchase and sale agreement?

At minimum, your contract should:

1. Identify the buyer and seller, and the legal capacities of each;
2. State that the buyer is agreeing to buy and seller agreeing to sell the property;
3. Provide a sufficient description of the property;

4. Identify the consideration—whether it's a fixed purchase price, or a clear method to calculate the purchase price, such as the amount per square foot to be calculated after the completion of a survey;
5. Provide for an outside closing date; and
6. Be signed by the parties to the contract.

Feasibly, a basic contract could be one or two pages. As public entities, there are undoubtedly so many other provisions which must be included, such as the facts and findings justifying the application of specific law to your transaction. Keep in mind that most contracts aren't started from scratch but rather employ so-called "precedent drafting"—i.e. using a model form of some kind as a starting point, and building off of that.

How specific does the property description need to be?

An accurate property description is crucial to keep a conveyance valid. Any real property to be purchased or sold must be described with sufficient certainty to enable not only the parties, but also a court of law, to identify it based on the description. The description should also be consistent in all transaction documents—i.e. the contract, the deed, any financing documents, and the title insurance policy.

An ideal description would be a plat of survey (the visual depiction component of the survey), coupled with written metes and bounds. The plat of survey should depict all structures, improvements, easements, and other non-financial encumbrances. The description should also include the city, county, and state of the property location. If conveying only part of a property, the correct portion must be clearly identified in order to effectively convey title.[1] Be mindful of your city subdivision ordinances as well, as platting requirements are usually implicated. In urban areas, references to a subdivision plat can sometimes provide a sufficient property description.

Accurate property descriptions can also be provided by references to other recorded instruments, but this only works if the recorded version itself is accurate, or if the parties are absolutely, positively sure that no alterations or other changes have been made to the property, such as recent improvements not referenced in the prior instruments.[2] Such references can be made by describing the previous instrument of conveyance (i.e. special warranty deed), along with the volume and page number or document number, and naming the county of record.

Can't I just use the appraisal district legal description for the property description?

Possibly, but proceed with caution as this is generally not recommended. The use of appraisal district legal descriptions is risky as they may too abbreviated or may not be accurate or specific enough to adequately describe the property.

[1] *De Martinez v. De Vidaurri*, 219 S.W.2d 823, 826 (Tex. App.—San Antonio 1949, writ ref'd n.r.e.).

[2] *Sorsby v. State*, 624 S.W.2d 227, 232 (Tex. App.—Houston [1st Dist.] 1981, no writ).

How much earnest money should a buyer pay?

Like most deal points, the amount of earnest money is negotiable between the parties. A typical amount is 3%-5% of the purchase price, but this can also depend on other factors such as the relative bargaining positions and financial means of the parties, the length of the inspection period, and the length of time before closing. Some contracts may provide for additional or extended feasibility periods upon payment of additional earnest money—for example, if the buyer needs extended time to obtain particular zoning, verify entitlements, undertake lengthy and involved environmental inspections, or receive financing approvals.

Do we even need a purchase and sale agreement? Can't we just use a deed?

The operative instrument of conveyance is a deed—whether it be a general warranty deed, special warranty deed, or no warranty deed. All three of these deeds contain the implied covenant of seisin—i.e. the seller owns what they say they own, and has the right to convey it in fee to someone else. The delivery of the deed—as signed by the seller and acknowledged—to the buyer, who accepts the deed, operates to convey title to the property and is enforceable between the two parties. It is the filing of the deed in the county records which provides notice to the world and makes the transaction enforceable against third parties. So, yes—a deed is legally all that is needed to transfer title, but realistically an agreement to memorialize other aspects of the transaction is almost always necessary.

What is the doctrine of merger, and why is it important?

Typically, real estate purchases and sale agreements involve (1) the purchase and sale contract, which provides the deal points, timelines, and other obligations of the parties; and (2), the deed, which is the actual instrument of conveyance. The delivery of a deed made in full execution of a contract of sale of real property—that is, it is delivered and accepted by the buyer—merges the provisions of the associated contract.[3] For example, if your purchase and sale agreement provides for the conveyance of a defeasible estate—i.e. "the property shall be used exclusively as a yodeling school, but in the event buyer ceases to use it as yodeling school, the property shall revert to seller automatically with no further action required on the part of the seller" —this language must be provided in the deed as well. In other words, if representations and covenants contained in the purchase and sale agreement are not consistent with the provisions of the deed, they merge into the deed and the deed governs. Exceptions apply when a purchase and sale contract provides for the performance of acts other than those particular to the actual conveyance.[4] For example, internal deadlines for providing surveys and inspecting the property relate to due diligence and don't belong in an instrument of conveyance such as a deed.

Keep in mind the merger doctrine is different from a "merger clause," which generally provides that a purchase and sale agreement contains the entire agreement between the parties, that there are no other agreements between the parties outside of the contract, and prior agreements and understandings (whether oral or written) are superseded by the agreement.

[3] *Harris v. Rowe,* 593 SW 2d 303 (Tex. 1979).

[4] *Id.* at 306.

Are purchase and sale agreements assignable to third parties?

Unless the agreement specifically and expressly prohibits it, purchase and sale agreements are generally assignable.[5] Therefore, it can be crucial to specifically prohibit assignment or limit it to a corporate affiliate of the buyer—especially with a city as seller. Consider the sale of real property in tandem with an economic performance agreement—an economic development corporation (and authorizing city unit) obviously needs to be able to identify who it is they are contracting with, in order to ensure continuity of ownership by a selected buyer, safeguard any required development of the property, appropriately provide for subsequent incentive payments, and other factors. Further, the governing body of a city or economic development corporation board is specifically authorizing via official action the party with whom the transaction will be undertaken and cannot authorize a sale to an unknown party, although in some circumstances, it may be appropriate to provide pre-authorization within the contract to a corporate affiliate of the buyer. So don't let this slip by.

Does a "Time of the Essence" clause really do anything?

Most form contracts come with a "time is of the essence" clause already contained within. The general effect is to make the adherence to internal contract deadlines, such as delivery of survey or the date of closing, material terms in the contract which can give rise to a breach of contract claim by the aggrieved party.[6] However, such clauses are subject to waiver if not consistently enforced. In addition, when a contract does not contain a "time of the essence" clause, a reviewing court will presume the parties intended for a "reasonable time" to perform, which may or may not align with the expectations of the parties.[7] Further, the finder of fact will have to determine whether a blown deadline constitutes a "material part of the contract,"—a determination not needed with a time of the essence clause.

How best to advise my buyer client regarding an "as is" clause?

As a buyer, an "as is" clause requires careful consideration and extra diligence. Purchasing property "as is" has the effect of releasing the seller for any responsibility from any breach of warranty or representation regarding the property. The buyer is relying solely on its own due diligence, and accepting responsibility for inspection of the property and its valuation. Such a clause negates the elements of reliance and causation—such as breach of contract, negligence, fraud, violations of Texas' Deceptive Trade Practices Act ("DTPA"), and breach of express or implied warranties—and the seller gives no assurances, express or implied, concerning the value or condition of the property.[8] If the value of the property turns out to be less than the purchase price, the seller is not responsible.[9] This serves to nullify most breach of contract claims, unless the seller has either withheld information fraudulently, or prevented the buyer's ability to inspect the property. It is imperative therefore that the Buyer be able to inspect the property to the fullest,

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[5] *Pagosa Oil & Gas v. Marrs & Smith,* 323 S.W.3d 203, 211 (Tex. App.—El Paso 2001, pet. denied).

[6] *Breof BNK Tex., L.P. v. D.H. Hill Advisors, Inc.,* 370 S.W.3d 58 (Tex.App.Houston [14 Dist.] 2012).

[7] *Rusk County Elec. Co-op, Inc. v. Flanagan,* 538 S.W.2d 498, 499-500 (Tex. Civ. App.-Tyler 1976, ref. n.r.e.).

[8] *Prudential Insurance Company of America v. Jefferson Associates, Ltd.,* 896 S.W.2d 156, 161 (Tex. 1995) (citations omitted).

[9] *Id.*

without obstruction; that the seller must be required to disclose all records and other information it has on the property—said records must be true, correct, and accurate. No party will know the property better than the seller, and there are things relating to property history a Buyer will not be able to ascertain through its own investigation.

We're a municipality, yet the closing documents require us to pay taxes. What the hey?

Likely, this is pertaining to the tax prorations commonly negotiated in real estate contracts. Generally, the parties prorate the ad valorem taxes which have already been assessed against the property (or, those costs are estimated based on the previous year's taxes if not yet assessed at closing). So, in these circumstances, if the city is the buyer, it will usually receive a credit from the seller at closing in the amount of the tax liability assessed (or estimated) on the property for the months of seller ownership during the year of sale. The city holds on to that amount until the tax bill comes due, and should timely pay it.

How are closing costs usually allocated?

Everything is negotiable, but typically the seller pays for:

1. The basic owner's title insurance policy (for the buyer);
2. Costs to cure title if the buyer provides objections to the title commitment;
3. Obtaining, copying, or delivering any seller records;
4. Half of the escrow fee;
5. The costs to prepare the deed;
6. Prorated taxes for the time of seller ownership during the year of sale; and
7. Seller's attorneys fees.

And typical buyer costs include:

1. Any additional title insurance policy endorsements or premiums to complement the basic policy;
2. The cost of a new survey;
3. Half of the escrow fee;
4. Recording costs; and
5. Prorated taxes for the remainder of the year, as of the closing date.

Any random thoughts?

A couple:

1. When drafting a real estate contract (or deed, or whatever), you don't have to write out the numbers in tandem with the Arabic numerals in parentheses. I stopped doing that last year, and now I just stick with the Arabic numerals. But if you nevertheless still do, keep in mind

that if there is a variance between unambiguous written words and numbers, the written words control.[10]

2. If you are closing with a title company, the title company and its underwriter will need to see evidence of authority to close—the earlier that is squared away, the better. An approved and signed adopting resolution is not only the (relatively) quickest to obtain but also most likely to be acceptable to the underwriter. If your title company nevertheless won't accept the resolution and insists on additional verification, it's time to find a new title company. Another option is to provide the meeting minutes reflecting the vote to approve the transaction, but this can cause undue delay if your deadlines are short—since the minutes still have to be approved by the governing body or board at a subsequent meeting.

3. If the other party is an entity, make sure it still exists—check the business filings in the Texas Secretary of State online records. Also, make sure the signatory is actually authorized to sign on behalf of the entity (this may require the provision of the entity bylaws or authorizing resolution, for example).

4. If you're the buyer, the seller should convey via general or special warranty deed, or, at the very minimum, a "no-warranty deed." These deeds at least contain the implied covenant of seisin (i.e. an assurance to the buyer that the seller actually owns the property being conveyed, in the quantity and quality which they purport to convey—and it is breached if the seller does not own the property).[11] Do not accept property "sold" to you via quitclaim, as a quitclaim is not even a deed and has no covenant of seisin, but only transfers any rights the other party may have in the property—which may be zilch.

Conclusion

To some of us, real estate agreement drafting is fun, and we do it frequently and joyfully. For others, it may bring little joy into our lives, or occur on a more sporadic basis. The handful of subjects provided herein are intended to provide a little guidance for some contract aspects, which should of course be considered and tailored appropriately to each real estate transaction. And of course, as this is only a guide for nonclients, it does not constitute legal advice. Good luck!

[10] *Guthrie v. National Homes Corp.*, 394 S.W.2d 494, 495 (Tex. 1965).
[11] *Jackson v. Wildflower Prod. Co.*, 505 S.W. 3d 80, 89 n. 21 (Tex. App. — Amarillo 2016, pet. denied.).