BASIC ELEMENTS OF THE RESIDENTIAL TRANSACTION

✓ ARRANGING THE DEAL
✓ LAWYERS

In re Lanza (1974)

✓ Greene (seller) hired Lanza (attorney) who also agreed to represent Connollys (buyers) without consulting Greene
✓ closing date altered, issue with post-dated check and condition of property
✓ Lanza’s conduct was unprofessional because: (1) he failed to consult Green before accepting clients with potentially adverse interests, as well as explaining the conflict to the Connollys; (2) he should have advised Green to insist on the full purchase price or a mortgage/security of the $1000 – and if neither were accepted, he should have withdrawn from the representing both parties
✓ the extent of necessary disclosure is important
✓ potential conflicts must be discussed
duties of each side’s attorneys:
✓ seller’s: oversee negotiations to modify the broker’s form of listing agreement; consider problems with mode of payment and tax consequences resulting, status of articles of fixtures or personal property, the time set for occupancy and the effect of loss by casualty pending the closing; contract of sale must be drafted with care paid to the financing contingency, any modification to a standard K should be checked by both buyer’s and seller’s attorneys
✓ buyer’s: in addition, she should inform the buyers of the limitations, if any, which impair the title; deed of mortgage and deed of trust must be prepared; the buyer should be advised as to tax consequences of how the title is taken, arrangements made for insurance, taxes, and other incidents of ownership to be taken care of at closing
✓ it’s generally suggested that even consensual dual representation of buyer and seller should not be permitted – it’s just too risky

malpractice

✓ victim must show the attorney failed to exercise the degree of care and skill commonly possessed by an ordinary member of the legal community and that the negligence was the proximate cause of the injury
✓ an unrepresented party will sometimes seek malpractice against an attorney of another party – traditional rule has barred liability in the absence of privity
✓ many courts allow recovery if the injured party was a third party beneficiary of the attorney-client relationship
✓ some courts even permit recovery by individuals who the lawyer knew relied upon his work

✓ BROKERS

✓ broker’s function is to provide information about the housing market to buyers and sellers who have no other source of expert knowledge about conditions in the housing market
✓ brokers have the capacity to influence their client’s purchases of other conveyancing services, such as title insurance and escrow services
brokers often provide clients with preprinted standard purchase agreement forms, sometimes preprinted with the names of particular firm for title insurance, escrow, etc.

quality of service competition: multiple listing service (MLS) organization through which each member gains access to information available to other members

MLS systems reduce the possibility that one members will be able to supply a client with exclusive useful information and their wide-spread use has eliminated a considerable amount of quality of service competition

price competition: competitive pricing still may occur in the brokerage industry (coordination of pricing in large industries is difficult, consumers are likely to be more sensitive to brokerage fees than to other fees) – also, coordination of pricing in an industry so large is difficult and there are no obvious mechanisms for price collusion, such as the requirement that rates be public

however, many brokerage fees are the same or approximately the same

avoidance of competition: brokers outside the MLS organization can rarely compete with members

within the MLS, members always know what other are charging because commissions are split between the listing and selling brokers – creates interdependency

an MLS could threaten members who depart from uniform prices with expulsion

brokers with lower commissions have trouble because cooperating brokers receive a cut of the fee and will steer buyers to brokers with traditional fees

all fifty states license brokers (must have basic and career-specific skills)

revocation may occur for fraud, deceptive advertising, untrustworthiness, and incompetence

unauthorized practice

non-lawyer brokers border on practicing law

brokers are a target of unauthorized practice charges, mostly for preparing sales contracts

charges are also lodged against title companies, for their involvement in closing (preparing deeds and title reports and obtaining affidavits to clear title)

in NJ, brokers have to advise of the risks of not using an attorney

Alaska grants more freedom to brokers, permitting them to prepare contracts, etc.

the “incidental test” – a nonlawyer may perform some legal tasks if they are minor and only incidental to the main service being offered

the “simple-complex test” – nonlawyers may perform simple legal tasks; only lawyers may perform complex tasks

the “personal representation test” – while a nonlawyer may not give legal advice to others, he may perform legal services for himself

anticompetitive practices among lawyers

increases the cost of residential transactions

minimum fee schedules for lawyer’s title examination held to violate Sherman Act in SCt. as price fixing
arrangements between lawyers and other conveyancing professionals have been criticized – problems may also arise when an attorney attempts to fill the role of other conveyancing professionals

**Real estate boards and associations**
- lobby on brokers’ behalf, averse brokers’ professional conduct and provide or support marketing facilities
- locus is the local real estate board, a voluntary association offering market and industry information to its members (those that belong to the Nat’l Assoc. of Realtors enforce the Assoc.’s Code of Ethics, and membership may be a prereq. to belonging to a MLS)

**Antitrust violations**
- mandatory commission schedules were the earliest form of price fixing
- SCt. has held they violate Sherman Act
- local boards stuck to recommending “fair and reasonable” rates after that – were attacked by the Justice Dept., so no real estate boards have entirely dropped recommended rate schedules
- exclusionary practices are checked by: (1) federal antitrust law; (2) state antitrust statutes; (3) common law
- “14 Points for Multiple Listing Services” binds Assoc. members and aims at curbing exclusionary practices
- federal jurisdiction does reach brokerage activities – Sherman Act
- MLSs do not violate antitrust laws

**Brokers and housing discrimination**
- blockbusting – stimulation of sales by representing to homeowner that the racial composition of the neighborhood was changing and property values were about to plummet (it’s statutorily prohibited)
- “racial steering” also prohibited – where broker directs white buyer to white neighborhoods and minority buyers to minority or mixed neighborhoods
- a broker may lose her license for discrimination

**Galbraith v. Johnston (1962)**
- agent suing for commission – sellers claim another agent made the sale
- nonexclusive listing was agreed upon; produced potential buyer but no K; sellers took farm off market; all brokers were informed; broker continued comm. with potential buyer; another agent got permission to list and produced same buyer; sale was made
- language of K, broker receives commission if, “sold within one year after the expiration of this listing to anyone with whom you had negotiation prior to expiration”
- broker must prove he was the procuring cause of the sale to receive his commission
- provisions of this type were enforced in exclusive listings, so they should be in nonexclusive listings also – so long as the K’s valid
- held for broker

**Tristram’s Landing, Inc. v. Wait (1975)**
- K action for commission – plaintiffs acted as non-exclusive brokers – no mention of commission, though defendant seller knew normal commission 5%
sale made by plaintiffs, down payment paid, dispute over closing, and sale not consummated, no attempt to enforce K but down payment kept, plaintiffs billed for commission and were refused payment
✓ the only reference to commission is in the purchase agreement
✓ this court agrees with the seller and reverses the decision
✓ general rule for receipt commission – the broker is entitled to a commission if he procures a customer ready, able, and willing to buy upon the terms and for the price given the broker by the owner
✓ but … it is also provided that no commission is due until the customer actually takes a conveyance and pays therefore
✓ here, broker not entitled to commission – the purchase agreement was not unconditional acceptance of terms and the commission is to be paid on the sale and there was no sale
✓ court adopts Ellsworth Dobbs, Inc. v. Johnson (commissions are generally expected to come from the proceeds of the sale)
✓ rules adopted by court: (1) must produce ready, able, and willing buyer, (2) buyer must enter into K, (3) buyer must close title
✓ no consummation, no commission (unless due to seller interference)
✓ rules may be circumvented by K language

forms of listing agreements
1. exclusive right to sell – most favorable to the listing broker, giving him the right to a commission if the property is sold by anyone, even the owner, during the term of the listing agreement
2. exclusive agency – entitles the broker to a commission if he or any other broker sells the property, but not if the property is sold through the efforts of the owner
3. open/nonexclusive – seller agrees to pay a commission only if the broker is the first to procure a buyer; if the property is sold through the efforts of the seller or anyone else, the broker has no claim
4. net – seller agrees to accept a specified price for the property and the broker receives any amount paid over that price

agreements cont’d
✓ courts construe ambiguous agreements against the broker
✓ an open listing will be found unless exclusivity is clearly indicated
✓ if in doubt, exclusive agency will be found rather than exclusive right to sell
✓ an exchange of property constitutes a sale for the purposes of receiving commission
✓ in open listings, which broker was the procuring cause of the sale? it varies by jurisdiction
✓ broker must produce a ready, able, and willing buyer under terms of listing agreement
✓ Ellsworth Dobbs – seller’s reasonable expectation is that commission will come out of sale proceeds – no closing, no commission
✓ Ellsworth has still been followed in some jurisdictions, but most recent decisions follow the traditional rule of awarding a commission on the procurement of a ready, able, and willing buyer even if the deal does not close
Ellsworth and Tristram’s Landing do not completely relieve seller from liability for the commission on an aborted sale – they allocate liability according to fault.

**Do brokers have rights against a buyer?**

- b/c residential brokers’ Ks are with the seller, in the past they’ve had few routes to recovery against buyers who have maneuvered them out of commissions of prevented closings.
- currently, tortious interference with contractual relations, 3d party beneficiary theory, and unlawful interference with prospective economic advantage are the main grounds for relief.

**Brokers’ duties to seller and to buyer**

- protect and promote interests of client; treat all parties to the transaction fairly.
- often a buyer’s broker is not he same as the seller’s/listing broker.
- if property listed with buyer’s broker’s office, he gets all commission; if property listed with MLS, will share commission with listing broker.
- seller initiates relationship with listing broker.
- buyer initiates relationship with selling broker.
- selling broker is the seller’s subagent and not the buyer’s agent – so there’s little fiduciary duty to buyer other than to deal fairly and honestly with him.
- a buyer without an attorney is pretty unprotected.
- not a good idea to insist selling broker advise buyer he’s acting solely as seller’s subagent b/c: (1) discourages/delays sale and encourages buyer to seek alternative representation, (2) a mere revelation that a subagency relationship exists fails to provide the purchaser with the protection he needs.
- dual agency – selling broker would be agent for both seller and buyer – but unlikely to provide adequate protection for buyer b/c: (1) conflicts are inherent in dual agency, (2) dual agent must obtain consent of each principal before representing them both (if fails to ask consent may lose the right to commission), (3) dual agent must withdraw if conflict arises.

**Daubman v. CBS Real Estate Co. (1998)**

- claim: breach of fiduciary duty.
- broker pushed a buyer on sellers with poor credit, though he represented the buyer as having good credit; K accepted; seller’s started building new home, broker went outside agreement to find alternate lender for buyers; sellers claimed purchase agreement now null; broker also checked on apt. lease behind seller’s back causing trouble for seller with complex co.; sellers refused to pay commission and filed suit.
- an agent is required to act solely for the benefit of the principal in all matters connected with the agency and adhere faithfully to the instructions of the principal.
- fiduciary duty to use reasonable skill, care, and diligence and to act honestly and in good faith.
- agent must make a full, fair, and prompt disclosure of all material facts.
- breach of duty may prevent commission.
- broker’s efforts with the buyer’s loan constitute a breach of fiduciary duty.
- court found for sellers.
damages are irrelevant when determining whether an agent’s breach of duty results in loss of commission

**Hoffman v. Connall (1987)**

- issue is whether a broker is liable for innocently misrepresenting a material fact about real estate to a buyer
- boundaries of property were inconsistent
- broker did not verify the property had been surveyed before seller bought it; broker showed the property with boundaries has he understood them and did not recommend a survey
- buyers, after purchasing, were enlightened that several things encroached on a neighbor’s property – cost $6,000 to rectify
- broker not liable for making innocent misrepresentations to buyer
- some courts, however, have held them liable b/c they’re in a better position to determine the trust of their representations than buyers
- problem: would have to impose a duty to inspect for defects – brokers would provide less information for buyers out of fear of suit
- or could look at this as the broker being protected from liability to the buyer under agency law
- but, middle ground: broker is negligent if he should reasonably know the falsity of a seller’s representation and should employ a reasonable degree of effort to confirm or refute information which is pivotal from the buyer’s perspective
- brokers would be held to same standard of reasonable care other professionals are
- requirement of knowledge – not present in this case
- a broker must **not** guarantee every statement made by a seller
- standard: a broker must exercise the degree of care that a reasonably prudent broker would use under all the same circumstances
- the broker did not breach the standard of care of a reasonably prudent broker
- nothing to put the broker on notice that the property lines were wrong
- surveying was not a prevailing practice in the real estate business
- dissent argues liability for any kind of misrepresentation; broker didn’t verify the existence of a survey at the very least

**Notes for above 2 cases:**

- usual remedy for breach of fiduciary duty is deprivation of the entire commission
- broker self-dealing – a broker, cannot, without the seller’s informed consent, purchase the property himself, split a commission, or take a rebate from buyer or buyer’s broker
- broker as middleman – if only brings the parties together (w/o discretion to negotiate or perform other services) can act for both buyer and seller without being held to a fiduciary duty to either
- do buyer’s have rights against a broker? courts generally hold that whether or not there is a MLS arrangement, the listing broker owes no fiduciary duty to the buyer; despite this, liability by the listing broker to the buyer may be premised on (1) agency relationship, (2) fraud doctrine (concealment of material information), (3) constructive trust for buyer’s benefit on any gains for broker self-dealing, (4) private right of action for damages for violating the disclosure and self-dealing provisions of the
state broker licensing statute, (5) general negligence where broker is agent for both buyer and seller is held liable to buyer for failure to disclose defects

✓ at least one court has held that a broker holding an open house was liable for injuries suffered by a looker caused by a condition in the tile floor
✓ net listing agreements harbor serious potential for broker abuse

✓ **Contract of Sale**

✓ **Risk of Loss**

✓ 5 different views for allocating the burden of fortuitous loss between vendor and purchaser of real estate:
  1. from time of sale contract, the burden falls on buyer even though vendor retained possession (most widely accepted)
  2. loss is on the vendor until legal title is conveyed though buyer’s in possession (strong minority)
  3. burden on vendor until legal title conveyed and then on purchaser, unless vendor is in such default as to preclude specific performance
  4. burden on party in possession
  5. burden on vendor unless something in contract or relationship of parties implies different intentions (not really an accepted view)

*Sanford v. Breidenbach* (1960)

✓ while under K, the home was destroyed by fire (before transfer of title)
✓ deed in escrow, not yet filed
✓ buyer had fire insurance
✓ seller had fire insurance but was cancelled w/o buyer’s permission or notice to him (policy was in effect at the time of the fire)
✓ seller sued
✓ buyer had made deposit, in escrow
✓ real estate no longer involved
✓ seller sought specific performance of K; buyer brought seller’s insurance co. into action
✓ a material part of the K had not been complied with by the time of trial – septic tank easement was still in question
✓ specific performance requires that the seller (the one seeking the remedy) was ready and willing to do all essential and material acts required of him by the agreement at the time of commencing the suit
✓ specific performance cannot be decreed in this case
✓ seller claims equitable conversion – ct. believes that equitable conversion only becomes effective when seller is entitled to specific performance
✓ ct. follows position that risk of loss should be on the vendor until the time agreed upon for conveyance of the legal title and thereafter on the purchaser, unless the vendor is then in such default as to be unable specifically to enforce the contract. - #3 above
✓ seller is responsible for loss
✓ seller had a viable policy – seller’s insurance responsible
✓ up to the moment the buyer refused to complete the K, he had an insurable interest in the premises
✓ *Sanford* explored 3 factors shaping the sale contract: conditions, remedies, and risk of loss
courts are reluctant to order specific performance of heavily conditioned contracts
statute of frauds is closely connected with other 3 factors – if a contract only barely complies with the statute of frauds and is not complete in all material respects, courts will often refuse specific performance
allocation of risk of loss – equitable conversion, though it’s suffered substantial inroads, continues to represent the majority rule in the US for allocating risk of loss from destruction during the executory period
growing trend – to replace equitable conversion with allocating risk of loss to whoever is in possession at the time the premises are destroyed (party in possession is in best place to guard against hazards, to insure, and to conserve evidence bearing on destruction)
allocation rules are rules of implication and may be altered by contract
UVPR (Uniform Vendors and Purchasers Risk Act) – shifts the risk of loss from destruction or condemnation from seller to buyer only if the buyer has taken possession or title
ULTA (Uniform Land Transactions Act) – regulates contract conditions, remedies, and formalities; no jurisdiction has adopted it yet
English Rule for allocation of insurance proceeds between buyer and seller is that the seller is entitled to retain proceeds free of any claim by the buyer
American Rule is that the buyer is entitled to the insurance proceeds, chiefly to avoid giving the seller a windfall (full purchase price plus full insurance proceeds) … unless state adopts minority rule and allocates risk of loss to seller, rather than buyer
3 justifications for American Rule: insurance proceeds are held by seller in trust for the buyer; since under equitable conversion the buyer is the equitable owner of land, he should also be considered the equitable owner of the insurance proceeds standing in place of the land; and since insurance is customarily considered to be for the benefit of the property rather than the person insured, the proceeds should go with the land

Baliles v. Cities Service Co. (1979)
action for specific performance, or damages
CSC orally agreed to sell employee 2 lots for residential development
applied for a loan
oral promise written for purposes of getting loan
received loan and began construction on one lot – had financial trouble
released other lot to CSC
assigned his interest to a guy Baliles
CSC wrote to say agreement was no assignable
Baliles seeks specific performance or damages
court found agreement satisfied SoF and valid assignment where house was “well under construction” – and when it was put under roof, a deed from CSC would be required for that lot; however, assignment of lot without construction not effective
CTA overturned – held agreement didn’t satisfy SoF and no part performance, no equitable estoppel
a condition precedent to receiving a deed (having the residence under roof) had not been met
to satisfy SoF, it must be clear in the agreement the land intended to be sold … memo drafted after oral agreement didn’t set out exact land to be sold (no county or state)

✓ doesn’t describe land with reasonable certainty

✓ part performance alone not enough for enforcement

✓ equitable estoppel only used where enforcement of SoF would cause hardship or oppression

✓ equitable estoppel should apply in this case – construction began, loan secured

✓ there was nothing to indicate the agreement was not assignable

✓ Baliles has the right to a deed when the condition precedent is met

✓ while a formally executed contract of sale meets the requirements of the statute of frauds, other pieces of paper generated during the sales process may also suffice

✓ this case lies between the two polar American views on the adequacy of descriptions in land sale contracts: (1) some courts treat contract descriptions far more liberally than deed descriptions, holding that land sale contracts will be enforced if it identifies the land to be conveyed to the exclusion of all other parcels – so long as the description offers some clue to identifying the land, parol evidence will be admitted to complete the identification; (2) a few courts insist that the contract descriptions contain all of the detail required for deeds

✓ some courts hold that the buyer’s entry onto the parcel under oral contract will suffice to take it out of the statute of frauds; some hold possession accompanied by some payment to the seller is sufficient, and some hold that possession and proof that removal will cause irreparable injury is sufficient

✓ electronic signatures are valid under the statute of frauds, but they increase the risk of unintended binding and forgery

✓ states can supersede act permitting electronic sigs, by adopting Uniform Electronic Transactions Act

contract conditions

✓ typical land sale K contains conditions that must be met or waived before closing

✓ one issue is whether conditions leave so much open that there’s no enforceable K (indeterminateness/SoF)

✓ added questions of illusoriness or mutuality of obligation

✓ reverse problem arises when contract conditions have been drafted with excessive detail (as in terms of financing)

✓ maybe we should require good faith when a condition is overly narrow

FINANCING

Homler v. Malas (1997)

✓ breach of K action

✓ Homlers claim Malas failed to diligently pursue loan apps … he wants his earnest money back

✓ Malas claims K is vague and indefinite, particularly the financing contingency

✓ summary judgment was granted in his favor

✓ document was a preprinted form with spaces left blank, including interest rates and monthly payments
failure to specify at what rate a buyer is to obtain a mortgage loan causes failure of a condition precedent enforceability

interest rate is an essential term

not even reference to a “current prevailing rate” … nothing from which an interest rate could be determined

grant of summary judgment was proper – gets his earnest money back

increasingly, indefiniteness is being resolved in terms of reasonableness and illusoriness in terms of good faith

a well-drafted contingency clause should prescribe the timing and type of notice that must be given in order to terminate the contract under the contingency clause

if financing condition specifies the terms of the mortgage loan, but also the particular institution that is to make the loan, will the buyer be excused if that institution rejects the loan application, but some other institutional lender agrees to make the loan on the terms specified? or if the seller agrees to purchase money financing? buyer’s arguments have been rejected.

but is it fair or efficient to let buyers use the financing condition to test their own judgment on the worth of the property, giving them an excuse to get out of the K if financing is refused because the appraisal comes in at less than the K price?

**MARKETABLE TITLE**

*Caselli v. Messina* (1990)

summary judgment granted to defendants

plaintiffs contracted to buy house of defendants and paid down payment

condition that title be marketable

plaintiffs received title report that title was unmarketable and requested return of down payment

K calls for standard title policy with unviolated covenant and restrictions

issue: does existence of unviolated covenants and restrictions render title unmarketable?

a marketable title is one which can be readily sold or mortgaged to a person of reasonable prudence, the test of marketability being whether there is an objection thereto such as would interfere with a sale or with the market value

mere possibility of defect does not produce an unmarketable title

it is therefore concluded, that no reasonable person, in the absence of a contractual provision calling for a special use of the property, would be denied reasonable enjoyment of the property for his “intended and announced purposes”

down payment will not be returned

dissent: buyer was not offered what he negotiated for

one variant formula to the generally accepted def. of marketable title above is that it’s title “which at all times and under all circumstances, may be forced upon an unwilling purchaser”

*Caselli* majority departs from the general rule that mere existence of covenant or condition automatically makes title unmarketable

unmarketability because of defects is different from unmarketability because of encumbrances (apparent v. non-apparent)
chain of title defects affect ownership … they may arise from: fraudulent transfer, an irregularity in the conduct of a mortgage foreclosure, tax sale or probate proceeding, or a technical error or omission in a prior conveyance

the standard marketability formula should properly be applied only to chain of title defects

curative acts, statutes of limitations, marketable title acts and recording acts dictate which title defects impair title and which, with the passage of time, have been cured

encumbrances: take the form of third party claims to money, possession or use affecting the land (mechanics liens, mortgage liens and judgment liens are typical money claims … claims of lessees or tenants in common typify possessory encumbrances … and easements, servitudes and party wall agreements are typical encumbrances affecting land use)

degree of encumbrance will vary over time and with owners

issue: who (buyer or seller) has the best access to the information that will avoid loss? the answer may turn on whether the encumbrance is visible from an inspection of the parcel

encumbrances imposing use restrictions are completely within the knowledge of the seller at the time she enters into the K of sale

buyer is in the best place to know about the uses that he plans to make of the property … buyer should lose in this context only when he has done nothing to inform the seller of his intended use and his use is unexpected in the circumstances … commercial use of a lot in a residential neighborhood

if the encumbrance is visible, rather than the paper record, it probably should not excuse buyer performance

buyer should always be aware of public roads – based on custom, buyer knowledge, implied waiver, private benefit, minimal interference

private rights of way and irrigation ditches often excuse performance

record title: title, typically in fee simple absolute, that can be proved by reference to the record alone and without resort to collateral proceedings such as quiet title actions brought to establish seller’s title by adverse possession

insurable title: title that a title insurance company is willing to insure as valid … need not be good record title or marketable title – the title policy may except defects or encumbrances that make the title unmarketable

**ZONING**


K for sale … potential zoning change that would activate retroactively

purchaser sought rescission

granted for mutual mistake of fact

affirmed

both municipalities’ by-laws were checked during negotiations

neither party aware of notice until 10 days before closing

buyer refused to close

zoning amendment adopted

generally such situations are the risk of the buyer

purchaser bore risk of zoning laws in effect at date of closing
✓ zoning amendment did not exist at closing, but published notice had a material impact on buyer’s intended use of premises
✓ at time of K, both parties though zoning by-laws were okay – though mistaken
✓ it was a basic assumption on which the agreement was made
✓ “the K is therefore voidable by the purchaser unless it bore the risk of the mistake. the agreement does not provide for that risk, and the case is not one of conscious ignorance or deliberate risk-taking on the purchaser’s part. nor do we think there is any common understanding that purchasers take the risk of the unusual predicament in which the purchaser found itself.

QUANTITY

Cedar Lane Ranch, Inc. v. Lundberg (1999)
✓ CLR brought an action to quiet title – was granted summary judgment
✓ affirmed
✓ both ranches believed there was a different distribution of land on each side of the highway
✓ disputed property
✓ issues: was there a transfer in gross and, therefore, the actual acreage of the conveyance was immaterial? and was summary judgment appropriate b/c CLR holds title to the disputed property by adverse possession?
✓ legal description of disputed property omitted from chain of title from 1950 on
✓ oversights not discovered until 1994 highway survey
✓ court held Nelson ranch had no title interest in disputed property and even if it did, CLR obtained the land through adverse possession
✓ sale in gross: the K of sale by the tract or in gross is one wherein boundaries are specified, but quantity is not material; each party takes the risk of the actual quantity varying to some extent from what he expects it to be
✓ amount of acreage immaterial b/c references to fixed, permanent boundaries in the conveyances, and no reference to price per acre, just a lump sum
✓ the language “more or less” alone does not create a sale in gross, but it is sufficient, combined with the observation of the property by the purchasers, the lump sum, and the lack of the statement of price per acre to create a sale in gross
✓ parties did not intend to convey a precise number of acres by the earlier deeds
✓ general rule: boundaries control in case of a discrepancy as to quantity
✓ land use controls enacted before K signing: general rule: ordinances enacted prior to the K are not treated as encumbrances and buyer has no recourse against seller
✓ courts are cautious to rescind for mutual mistake
✓ land use controls enacted after signing: courts are divided – majority hold buyer bears risk of changes in the law, others follow the example of equitable conversion – parties can shift burden of loss by K
✓ land use controls violated before contract signing: courts are divided – some treat like encumbrances placing burden on seller
defective descriptions: general rules to be applied when the seller owns less or more than the land described in the K – accurately portrayed by CLR

K for sale may also include personal property, will it will not be implied as part of the land sale

attorney approval clauses: makes the K binding only on the approval by the buyer’s and seller’s attorneys within a specified time (3-7 days) or permits cancellation if either party’s attorney disapproves the K within a specified time

attorney may reject for any reason or no reason

when a legal remedy is sought, performance on the closing date will be considered essential unless the K disclose a contrary intent. actions for an equitable remedy – time is not of the essence unless the K or surrounding circumstances indicate that it should be

complex conditions occur more frequently in commercial transactions where purchases of land for development purposes must be carefully conditioned on the completion of arrangements for construction and permanent financing and receipt of all the government approvals necessary for the projected development

**Calculus of Remedies**

4 possible buyer’s remedies:

- specific performance
  - land is unique – money damages are often inadequate
  - the requirement that a party seeking s.p. remain ready to perform puts a burden on the buyer, who must arrange with his lender to keep his loan commitment alive, as well as on the seller, who may have intended to move from the house, using the cash from its sale to buy another
  - a seller facing a rapidly falling market, or a buyer facing a rising market may prefer it anyway
  - s.p. will be denied if the contract involves inadequate consideration or is unconscionable or oppressive to the party against whom it is sought to be enforced
    - d.c. granted conditional s.p. and sc.t. affirmed
    - arrangement to develop theatre/restaurant
    - new agreement was reached after a financing mess and the sale of TD
    - got appropriate licenses
    - TD deposited deed in escrow, at which time it was marketable
    - then liens were filed again the property/project and title became unmarketable
    - closing didn’t happen
    - liens were released but cost went up – Kessler filed for s.p. of agreement with TD
    - Kessler could only have s.p. if he shared the increased construction costs
there were 3 potential remedies in the purchase agreement: earnest money, default provision, and title insurance provision – created ambiguity

none of the listed remedies were adequate (no earnest money was deposited that could be returned, eliminating both the earnest money and title ins. provisions, and the default provision dealt solely with TD’s remedies)

found the agreement did not limit Kessler’s right to s.p. – especially in light of the fact that no other listed remedies applied

there is no legal right to s.p.

the inadequacy of remedies at law is presumed in an action for breach of a real estate purchase and sale agreement due to the perceived uniqueness of land

s.p. should be equitable to both the plaintiff and defendant, and a court of equity is capable of rendering a conditional decree in action for s.p. because it can insist that if a party seeks the assistance of such a court, he must do what good conscience demands in the particular case

the court found that it would be inequitable to either deny Kessler s.p. entirely or to grant s.p. without a contribution by Kessler toward the unexpected additional costs of construction and the dismissal of his damage claims

s.p. is granted in favor of a vendor as freely as in favor of a vendee, though the relief actually obtained by him is usually only a recovery of money – the purchase price … 3 reasons why

remedy at law by damages is inadequate b/c usually only returns the difference b/t market value and purchase price, but he may be in need of entire purchase price

under equitable conversion, the vendee is the trustee of the purchase price for the vendor, and the vendor through s.p. enforces this trust

mutuality – where the vendee has an equitable remedial right, so should the vendee

land may possess unique disadvantages for the seller, such as exposure to liability for dangerous conditions on the land

a buyer’s asserted cause of action may make it impossible for the seller to dispose of the property elsewhere so long as the claim is outstanding

in the absence of some objective indicator of the land’s market price, such as value established by frequent sales or condemnation proceedings of substantially similar land, it is apparent that the vendor may in fact not have an adequate remedy at law

occasions to refuse s.p.

unfairness, inadequate consideration, unconscionability and overreaching are just a few

courts have said condos are not unique, but must don’t

damages

Raisor v. Jackson (1949)
buyer sued for seller’s breach
received nominal damage
substantial damages only available if seller acted in bad faith or was guilty of factual fraud
seller’s wife refused to sell her ½ interest
down payment returned
soon sellers sold to another buyer
seller clearly breached
conflicting precedent
held – buyer can recover substantial damages – good faith is immaterial if he breaches his agreement
this court follows the increasingly less followed Flureau rule that the buyer’s damages are limited to defects that the seller knew or should have known about
3 justifications: curbs the jury’s freedom to award unbounded and speculative damages,
American rule: awards loss of the benefit of bargain damages
rescind and recover deposit
vendee’s lien on seller’s legal title
the lien is simply a remedy created by the courts, and has no connection with the contract except that the vendor’s failure to perform his contractual obligations furnished the justification for the application of this remedy
4 possible seller’s remedies:
specific performance
Tombari v. Griepp (1960)
plaintiffs sought s.p. of a sales K
defendants admit they refused to perform, but asserted (1) neither the plaintiff nor his wife signed the K, (2) legal description was not sufficient, (3) after agreement, property discovered not suitable for buyer’s purposes, (4) plaintiffs did not perform and cannot perform
plaintiff admits the wife didn’t sign, but she’s not willing and able
the K must be such that at the time it is entered into, it is enforceable by either of the parties against the other
when the plaintiff’s wife entered the action, the K became mutually binding
wife, by joining the action, accepted the voidable action of her husband
vendor, as well as vendee, may obtain s.p.
dissent: wife not signing made the K unenforceable and void
even if she did ratify it, it was not timely
offer to purchase was withdrawn before ratification
no showing the remedy at law is inadequate
damages
general rule measuring seller’s damages from the date of buyer’s breach rather than from the date of resale, has been criticized for failing to account for the difficulties and delay in reselling land. Despite this criticism, Kuhn is an atypical decision and most courts continue to follow the general rule.

With respect to earnest money, the general rule is that the seller may keep the buyer’s deposit even though forfeiture is not expressly prescribed by the K, and even though the sum exceeds the seller’s provable damages. Some jurisdictions say the seller can keep only so much of the deposit as is necessary to cover her damages – but the buyer’s burden of proving this will be difficult. Sellers can by K forestall claims of unjust enrichment by characterizing the deposit obligation as a liquidated damages provision.

Liquidated damages clauses have their own requirements – liquidated sum must be proportioned to the K price and must represent a reasonable forecast of compensation for the harm caused by the breach … and the harm must be of the sort that’s difficult to estimate accurately.

States are evenly split on those following a “first look” approach – considering the reasonableness of liquidated damages only as of the time of K formation, and a “second look” approach – considering the reasonableness at the time of breach also.


- Plaintiffs contracted to by a home contingent on them obtaining a mortgage to finance the purchase
- They lied on their mortgage app to get it
- Mortgage co withdrew the loan
- 2 sources of damages: (1) decreasing the value of the house in the market, (2) cost of holding house until it could be resold
- Mutual rescission represents the most common resolution of land sale breaches, at least in the residential setting
- Unilateral rescission takes 2 forms: (1) equitable rescission (an action for a rescission) where the disappointed buyer or seller seeks a judicial decree terminating the K, (2) legal rescission (an action on rescission) where the buyer or seller declares that the other’s conduct constitutes grounds for terminating the K
- Rescind and retain deposit
- Vendor’s lien on buyer’s equitable title
  - Attaches to the buyer’s equitable interest in the property automatically upon execution of the K
  - May be particularly important in an installment sale K – enabling the seller to foreclose the foreclosure of a purchase money mortgage
- Foreclosure on the vendor’s lien may offer an attractive alternative to the seller who is unable to tender the marketable
title required for s.p. or whose misconduct would disqualify her from s.p.

- 2 disadvantages to foreclosing on the vendor’s lien – deficiency judgments may be prohibited and statutory redemption periods may be required
- for the buyer, the vendee’s lien provides security for the return of his deposit but typically will not secure his claim for title examination and survey costs and benefit of bargain damages

- **Grace Development Co., Inc. v. Houston (1975)**
  - issue: whether plaintiff was entitled to file a notice of lis pendens (pending lawsuit) in connection with its action against defendants for certain monies allegedly due to plaintiff pursuant to various Ks for the sale of land and the construction of a house on the land
  - a vendor’s lien is an implied equitable lien upon real property for the amount of the unpaid purchase price. It exists independently of any express agreement at the time of the conveyance and without regard to the absence of the grantor’s intention to claim it
  - a party may file a notice of lis pendens in all actions in which the title to, or any interest in or lien upon, real property is involved
  - if there’s no purchase price owing, there’s no vendor’s lien
  - debt must be for the purchase price of real property – where personalty and real estate are sold at the same time for a gross consideration, there is no implied or equitable lien upon the real estate unless the court can accurately ascertain the amount of the charge attributable to the purchase of the real estate
  - plaintiff doesn’t allege money owed is for the purchase price
  - no vendor’s lien in this case – inadequate to support filing of lis pendens

- **Closing the Contract**
  - steps prior to closing:
    - assemble basic data (location, buyer, seller, sale price, payments, closing date, special terms, who pays transfer tax, legal description, title, surveys, etc.)
    - financing
    - determine whether there is to be an assignment of a lease or delivery of immediate possession
    - ensure client obtains a fire insurance binder
    - examination of title (ascertain that title to the property is vested in the seller, determine the marital status of the parties, and determine whether or not there are any outstanding court proceedings that affect the transaction)
    - taxes and prior liens
    - prepare for closing (prepare deed, bond or note, mortgage or deed of trust, determine that the names of the parties are correctly set out on the closing document)

- **McDonald v. Plumb (1970)**
  - grantor’s sig. forged and deed of sale recorded
notary signed, then another transfer
issue is whether the false notarial acknowledgment (by Plumb) was a proximate cause of the McDonalds’ (ended up with property) damage
to prevail McDonalds must show a duty on the part of Plumb, a violation of the duty, violation was proximate cause of injury, and the nature and extent of their damage
respondent concedes violation of duty, creating liability upon the notary’s surety
false acknowledgment is at least one proximate cause
judgment in favor of McDonalds
subsequently, CA statute amended to relax proof of identity on which a notary can legally rely
notary dishonesty is on the rise
forged deeds are inadequate to pass title

✓ deed elements and construction
✓ modern trend is to simplify deeds
✓ premises of the deed: names of grantor and grantee, words of grant, background facts and purposes, consideration, and the legal description of the parcels conveyed
✓ habendum: describes the interest taken by the grantee, any conditions on the grant and any covenants of title (warranty clause)
✓ execution clause: grantor’s signature, seal, and the date of the deed
✓ acknowledgement: public officer/notary attests to the execution
the deed must be written, it must name the grantor and grantee and contain express words of grant, and it must describe the parcel conveyed
a seal is not always required
the acknowledgement is required for a deed to be legally recorded – it also makes the deed admissible into evidence without further proof of execution and it creates a presumption that the deed is genuine.

✓ Barrier v. Randolph (1963)
issue: are all the “conditions, reservations and restrictions” set forth in the deed repugnant to the granting, habendum and warranty clauses of said deed and therefore surplusage and void ab initio?
no, they’re not
always look at the whole instrument and the intentions of the parties in it
granting clause generally controls over the habendum
when inconsistent, printed words give way to written ones
deed will be construed most strongly against the grantor or against the grantee when it was drafted by him

✓ delivery
deed must be delivered to effectively transfer
delivery requires physical transfer and present intent by the grantor to transfer
but, if the intent is clear, courts will often find delivery without physical transfer, through devices such as symbolic, constructive or agency delivery
but physical transfer creates presumption of delivery and failure to physically transfer creates presumption of non-delivery
recordation of deed and acknowledgement also create presumption of delivery
delivery requires the grantee to accept delivery
courts will not presume acceptance if disadvantageous to grantee
grantor must have adequate mental capacity and not subject to undue influence

✓ Wiggill v. Cheney (1979)
where deed remained in a safe deposit box, and grantor handed over key, delivery not effective
grantor must part with possession of the deed or the right to retain it – she remained in sole possession
escrow has somewhat eliminated delivery issues (except in donative transfers)

escrow
3d party, escrow holder, holds the deed and purchase money from buyer pending fulfillment of the K conditions
if one or more of the conditions are not fulfilled, the hold will return the docs and funds to the appropriate parties
well-drafted escrow instructions will contain only objectively verifiable conditions

In re Akivis (1985)
escrowee must make independent determination of compliance unless impossible
attorney did not independently inspect compliance
liability of an escrowee is akin to that of the employer of an independent contractor
costs vary with who acts as escrowee and what functions they perform
some states regulated escrow personnel, others regulate escrow practices rather than personnel

liabilities that survive the deed
under doctrine of merger, a deed conveying real estate supersedes any conflicting terms in the K of sale and becomes the sole measure of the parties’ rights and liabilities
just as the deed may specify obligations not mentioned in the K, so the K may effectively provide that it, and not the deed, is to control certain obligations
merger is characteristically a seller’s doctrine, employed to repel buyer claims based on pre-closing undertakings

Reed v. Hassell (1975)
plaintiffs demand damages from encroachment of road on property they bought (both parties were unaware)
agreement wouldn’t have been entered into – growth on lots made inspection impossible
discovered 2 years later
no fraud, but road was breach of special warranty read into the deed
court held it could have been discovered, but that the parties didn’t intend that risk was to be assumed by the buyer
deal is executed, sales K becomes void
rule subject to exceptions and the intent of the parties is controlling
merger rule developed to cater to situations different from that at hand – where vendor undertook obligations
court applies merger rule to carry out intent of parties
they may recover damages
collateral promises unrelated to title or possession are not merged into the deed
function of merger doctrine: while the immediate buyer and seller can safely look outside the deed to resolve their mutual intent, a future buyer of the land can rely only on the intent expressed in the 4 corners of the recorded deed
courts look outside deed only where present parties will be affected, and look only within deed where successor 3d parties will be affected
merger does not affect seller liability for fraud

fitness of the premises
relief has come under theories of tort (fraud, misrepresentation, nondisclosure) and new notions of implied warranty

- liability of seller:
- tort – action lies for misrepresentation, provided that the assertion was untrue, fraudulent or material, and was reasonably relied upon by buyer

**Stambovsky v. Ackley (1991)**

- haunted house
- broker under no duty to disclose – ct. will permit duty to rescind and recover down payment
- no duty in NY for vendor to disclose unless there’s fiduciary duty or active concealment
- key factor in finding liability – relative access of buyer and seller to pertinent information
- buyer still has duty to inquire
- Stambovsky not the norm – laws are pro seller
- other states have passed “psychologically affected” property laws
- courts generally hold a buyer doesn’t have to disclose value information to seller that seller is unaware of
- some cts. require the buyer to disclose if asked directly
- “as is” clause will not bar recovery based on fraud
- criminal liability for nondisclosure – a seller was convicted of manslaughter for not disclosing carbon monoxide problem

**WARRANTIES**

**Wawak v. Stewart (1970)**

- flooding problem due to construction
- issue: is there an implied warranty in a new house? yes.
- no caveat emptor for new homes

**Blagg v. Fred Hunt Co., Inc. (1981)**

- does liability of the builder-vendor extend to the second or third purchaser? yes, but in this case, that purchaser bought 9 months after completion – there is a point in time when it won’t extend – should be based on a standard of reasonableness
- courts have declined to impose liability under warranty theory on a non-builder seller of a used home
- a lot of courts, unlike Blagg, refused to extend the warranty to subsequent purchasers
- most courts that have implied a warranty of fitness into sales of new housing have reasoned by analogy to the warranty of fitness implied into sales of personal property
- most courts that imply a warranty of fitness into the sale of new housing will also allow seller and buyer to K around the implied warranty

**liability of lenders and others**

- common law theories: fraud, breach of fiduciary duty, duress, failure to act in good faith, excessive control of the borrower, intentional infliction of emotional distress, joint venture theory, principal-agent violations, equitable subordination, negligence in loan administration, misrepresentation, and aiding and abetting liability, RICO, federal tax and securities laws, and the Comprehensive Environmental Response, Compensation and Liability Act
- lenders have been held liable for improper interference with borrower’s corporate entity, refusal to lend funds which have been orally promised, failure to obtain credit
life insurance for borrower as bank had represented, lack of adherence to standard policy in denying a loan, and failure to give notice before discontinuing funding
✓ there’s no really general theory of lender liability
✓ some commentator’s question the doctrine
✓ Rice v. First Federal Savings and Loan Ass’n of Lake County (1968)
✓ Jeminson v. Montgomery Real Estate and Co. (1973)
  - issue: whether there’s a claim against the mortgage co.
  - unitary, not binary transaction – signed a purchase agreement with co., and then later in an independent transaction, signed a mortgage agreement with the mortgage co.
  - therefore, any fraud attributable to the purchase agreement can’t be ascribed to the subsequent mortgage agreement
  - doctrine of “close connectedness” not applicable
  - mortgagee had no real interest in the sales transaction
  - actions against lenders have been generally unavailing
  - cases also reject liability of permanent lenders
  - limited circumstances in which the lender has been held liable for defects in the premises – where lender and developer were engaged in a joint venture, where the construction lender took control of the job upon default of borrower and complete the building, and where the construction lender continued to disburse to the builder even though the borrower had complained about defects
✓ brokers’ liability for defects rests on fraud
✓ architects’ liability is a new development
✓ government agencies are not liable almost always

✓ title
✓ prudent buyer will go beyond a record search – look at covenants (promises) incorporated in seller’s deed to buyer
✓ 6 standard title covenants:
  ✓ covenant of seisin: seller’s promise that she owns at least the interest in land that she is purporting to convey to the buyer
  ✓ covenant of the right to convey: seller’s promise that she has full power to transfer the interest that the deed purports to convey – overlaps cov. of seisin, but provides protection in occasional circumstances where the co. of seisin doesn’t
  ✓ covenant against encumbrances: seller’s promise that no outstanding encumbrances affect ownership or use of the land
  ✓ covenant of warranty: most frequently used cov. – obligates the seller to compensate the buyer for any losses when the title conveyed falls short of the title the deed purports to convey. general warranty – encompasses all defects in title and shortages in the area conveyed, regardless of the reason. special warranty – limits the defects covered – may cover only those defects that arose while the seller owned the land
  ✓ covenant of quiet enjoyment: seller’s promise that the buyer’s possession will not be disrupted either by the seller or by anyone with a lawful claim superior to the seller – does not protect against intrusions by trespassers.
  ✓ covenant for further assurances: rarely used, but obligates the seller to take such further reasonable steps as are necessary to cure defects in the buyer’s title
✓ present covenants (breach may only occur before/at time of delivery and statute of limitations runs from then): seisin, right to convey, and freedom from encumbrances
✓ future covenants (breach occurs sometime in the future): warranty, quiet enjoyment, and further assurances
ASSURING TITLE

✓ record system exists to protect buyer
✓ first in time, first in right rule (not generally efficient or fair) – first recording acts were passed to resolve its shortcomings and replaced this common law rule
✓ rule became first to record, first in right
✓ even though every state has recording acts, they only partially replace the common law rule of first in time, first in right – common law still governs where the recording acts do not apply
✓ where local recording acts doesn’t require recordation, the recording act will not protect second takers
✓ some states exempt leases of 7 years or less, and some except leases of 1 year or less

✓ purpose of land recording acts? to provide a public record of transactions affecting title to land and (1) to enable interested persons, like tax collectors, to ascertain apparent ownership of land, (2) to furnish admissible evidence of title for litigants in a nation where landowners did not adopt the English practice of keeping all former deeds and transferring them with the land, (3) to enable owners of equitable interests to protect such interests by giving notice to subsequent purchasers of the legal title, (4) to modify the traditional case-law doctrine that purchasers and other transferees, no matter how bona fide, get no better title than the transferor owned.

✓ race recording acts (2 state minority): priority determined by a race to the records – an unrecorded conveyance would be valid as to the grantor, his heirs, devisees, donees, and anyone else other than “lien creditors or purchasers for a valuable consideration.” it enable the title searcher to rely upon the records without the substantial risk under other types of acts that one will have constructive notice of unrecorded instruments.

✓ notice recording acts (evenly split): gives priority over unrecorded instruments to subsequent purchasers only if they are without notice. a title search will inform buyer of any recorded, adverse interest that will operate to defeat his title under the doctrine of constructive notice. however, buyer must not only search title, but must also inspect Blackacre for physical evidence of title defects or encumbrances, such as possession by someone other than the seller, putting him on inquiry notice of an adverse claim

✓ race-notice recording acts (evenly split): gives priority over unrecorded instruments to subsequent purchasers only if they are without notice and record first
✓ when an instrument is recorded, the record gives constructive notice of its existence and may be an important factor in any controversy in which notice is relevant. also, notice disqualifies purchasers and creditors from gaining priority and thus, notice is in effect a substitute for recording
✓ courts have generally held that one is given constructive notice only of those recorded instruments which are within his “chain of title”

✓ 3 forms of notice: (1) actual notice – notice given by the subsequent purchaser’s actual knowledge of the prior transfer (2) inquiry notice, or implied actual knowledge – notice given by the subsequent purchaser’s actual knowledge of facts that, if reasonably inquired into, would produce actual knowledge of the prior transfer (i.e., knowledge of possession by someone other than seller, defects and discrepancies in the deed, etc.) (3) constructive notice, or record notice – notice given by the prior transfer’s recordation in the public title records so that the subsequent purchaser, conducting a reasonable title search would obtain actual knowledge of the transfer
general trend is to follow agency rules and impute the attorney’s knowledge to his client

**purchaser for value:** recording acts are now deemed to protect those with even an equitable interest if consideration has been given

in order to be protected, a subsequent purchaser must have purchased his interest for value

antecedent debt as consideration – usually means not a purchaser for value and therefore cannot invoke the recording acts – must be contemporaneous consideration

**circuitous liens:** see notes

**indices:** grantor/grantee indices – instruments are first recorded and then indexed under the name of the granting party on the appropriate page … then the same notations are made as the transaction is indexed under the name of the grantee or the receiving party. tract indices – each parcel of land in a certain area is assigned a separate page in the index and every subsequent transaction affecting this property will be noted thereon – all the instruments which affect the title to a particular parcel of realty will be noted on one page of the index – uniform adoption of the tract index has been urged by many legal scholars.

when a grantee makes an error in a doc that causes it to be indexed outside of the chain of title, there is no constructive notice of the instrument

all indices are incomplete, and the title examiner must look outside of them generally

tract indices are superior in terms of depth, speed, and accuracy

**estoppel by deed:** if A, not owning Blackacre, purports to convey Blackacre to B by warranty deed, then if A later acquires title to Blackacre, her title will automatically pass to B under the terms of the deed

**title abstract:** summary beginning with a caption (full description of property) and ending with the certificate of the abstracter (list of all records examined an further sets out the period of time covered by the abstract)

abstracters may be liable for errors and omissions in compiling the abstract, lawyers may be liable for errors in analyzing the abstract and opining on title

tort theory represents the buyers primary route for recovery against an abstracter with whom they will commonly not be in contractual privity

lawyers are held to the traditional standard of reasonable care and skill – good faith judgments in error are excused, and the lawyer is not considered to have guaranteed that title is perfect – unless specifically made

custom will not excuse grossly unreliable practices

title insurance: may insure against on- and off-record risks (misindexing of a doc, matters pertaining to party identity, delivery to the transferee, etc.)

many title are doubly assured, through title warranties given by the seller and title insurance from an institutional insurer … a buyer who cannot get his title ins. co. to delete an exception from its policy may turn to his seller and insist that she cover the exception by a deed warranty

one time premium made to reduce risk of casualty – not to cover it when it happens (although that’s a part of it)

**Financing the Purchase**

mortgage at common law: conveyance of estate by the borrower to the lender as security for debt … in fee simple … borrower could only redeem land on one agreed date – that’ was his only chance
mortgage in equity: even though the borrower’s contractual right to redeem may have passed, he could petition a court of equity to let him redeem his equitable right at any time thereafter, on paying principal, interest and costs and giving proper notice to the mortgagee.

foreclosure: curtailing the equitable right to redeem

unless the mortgage provides, the mortgagee can foreclose the mortgagor’s equity of redemption only by judicial action and sale

lender in several states prefer the deed of trust to the mortgage with power of sale

deed of trust – the borrower (trustor) conveys title to the lender’s nominee (trustee) as security for the trustor’s performance of its debt obligation to the lender (beneficiary) – if the trustor defaults, and if the beneficiary so requests, the trustee will arrange public sale of the land to satisfy the debt

installment land contracts: often used to finance the acquisition of housing or of undeveloped land – seller holds title during the entire executory period, until the last payment is made, when the K closes and title is passed

leases

equitable mortgage: a court will hold a deed absolute to be an equitable mortgage when the evidence suggests that the parties intended a mortgage. situation arises when a landowner, faced with tax or mortgage foreclosure, conveys his land to a 3d party who promises to straighten things out and then reconvey the land to the landowner (mortgage disguised as a fee)

some states adhere to the old common law title theory of mortgages that the mortgagee holds title to the land from the time of the execution of the mortgage

most states now follow the “lien theory” where the mortgagee only has a lien on the property to secure the mortgagor’s performance

mortgage terms: interest rate, amortization rate, term, and loan to value ratio.

adjustable rate mortgage: the interest rate paid by the borrower varies over the life of the loan according to the designated index of current market rates … borrower’s concerns that interest increases might outpace increases in their income, thus jeopardizing their ability to pay, were assured by legislated limits on the frequency and amount by which interest rate could be increased

price level adjusted mortgage: it’s the loan principal, not the interest rate, that varies over time … at the end of each year or other agreed-upon period, the principal outstanding is adjusted up or down according to a prescribed inflation index – the risk here is that the borrower’s income will not keep pace with inflation over the life of the loan

renegotiable rate mortgage: (“rollover mortgage”) a series of renewable short-term notes – usually for 3, 4, or 5 years – secured by a long-term mortgage of up to 30 years with principal fully amortized over the longer term. at the end of each term, the borrower can choose to pay off the short-term loan or rolling it over into a new loan with the same terms, except interest rate

graduated payment mortgage: long-term fixed rate mortgage in which the monthly payment gradually increases over the life of the loan – designed to meet the needs of younger borrowers who expect their income to increase over time

growing equity mortgage: long term, self-amortizing, fixed interest mortgage under which the borrower’s monthly payments increase each year by a predetermined amount, typically 4%. proven attractive to home-buyers with increasing income and who are willing trade tax-deductivel payments for the comfort of knowing their homes will be paid off in a comparatively short time
✓ **shared appreciation mortgage**: reduces the interest rate to below market levels in return for the lender’s right to receive a predetermined portion of the property’s increase in value over the life of the loan

✓ **buy-downs**: in return for the seller’s payment of a lump sum to the lender, the lender will reduce the interest charges in the loan’s early years to a below market rate – typically used by developers to buy-down the institutional lender’s interest rate for the first 3-5 years of a long term loan

✓ **reverse annuity mortgages**: aimed at older homeowners on fixed incomes who find it difficult to make ends meet in an inflationary economy … uses the equity in the home as security for an annuity, giving him monthly payments over his lifetime or some predetermined period – then the entire debt is to be repaid at the earlier of ten years from the beginning or the death of the borrower, with funds to come from the sale of the property or probate of the estate

✓ courts have rejected attempts by the mortgagee to “clog” the equity of redemption such as a provision requiring the mortgagor to deliver a deed to the mortgagee on default

✓ mortgagees have been subject to lender liability claims for various activities in the origination and administration of loans

✓ **usury**: state usury limits still govern real estate lending arrangements other than first lien residential loans

✓ **dragnet clauses**: mortgage provision stating that it serves as security not only for the debt in connection with which it was created, but also as security for any other debt owed by the mortgagor to the mortgagee

✓ **after-acquired property clauses**: opposite of dragnet clauses – secure a single debt with the original property and all future property acquired … recording acts generally shelter the later acquired property from the original mortgagee’s rights … as being outside the chain of title

✓ **evaluating the borrower and the security**: security property must substantiate requested loan amount, borrower’s ability and willingness to repay the loan must be considered, terms of the loan must be reviewed

✓ lender’s are permitted to consider occupation and age in determining whether the applicant’s income will support the extension of credit

✓ credit will be looked into in the areas of income, assets, and debts

✓ assessing risk involves looking at 3 main factors: potential borrowers, security property, and loan terms

✓ expected monthly payments should not exceed 25-30% of gross monthly income

✓ total monthly payments shouldn’t exceed 33-36% of gross monthly income

✓ in appraising the property – look to market data, comparable properties, replacement cost, income it would produce

✓ redlining – lenders once marked local maps in red pencil to indicate neighborhoods in which loans were disfavored

✓ **rights and liabilities of junior lienors**: they can proceed against the mortgagor for waste or violation of other obligations imposed by the mortgage … in the event of default, they can proceed against the mortgagor on the debt and, subject to the rights of the senior mortgagee, can proceed by foreclosure against the mortgaged property

✓ the majority of courts bar subrogation in a third party refinancing if the lender had actual notice of the intervening lien

✓ as a general rule, courts will protect junior mortgagees against loan extensions or negotiated increases in the interest rate of principal amount of senior debt on the
theory that these changes increase the probability of default and decrease the cushion of value on which the junior lienor can rely in the event of foreclosure

✓ the presence of a junior mortgage may cause the senior lender to lose rights under its mortgage – the senior lender may be subject to increased exposure to liability from a junior lender

✓ if a second mortgage is foreclosed and the property sold to a new owner, the first mortgagee will have to deal with an owner it did not submit to its screening procedures who may lack the financial ability to pay

✓ **due on sale clause:** requires the mortgage to be paid upon transfer of the property

✓ **purchase money priority:** they enjoy a preferred position … rationale being that earlier lienors, unlike the purchase money mortgagee, did not rely on the property in question when they extended credit to eh mortgagor

✓ **transfers by the mortgagor:** subject to: mortgagee wil have no recourse against the transferee personally but can obtain relief against the mortgagor personally or against the land through foreclosure. assumes: transferee personally liable and the mortgagor still has recourse against the land

✓ **limitations on the transferor:** due on sale clauses that make the loan due upon the property’s transfer to avoid the risk of rising interest rates and the risk of waste

✓ **prepayment penalties:** often six months’ interest – payable in the event the mortgagor seeks to repay the loan before maturity … even absent a provision, a borrower is not entitled to repay whenever he wants – lenders typically take mortgage notes as an investment, to be paid off over a specified term (although some courts/jurisdictions have no problem with prepayment)

✓ **transfers by the mortgagee:** although both note and mortgage are transferred, the note is the controlling document

✓ **holder in due course:** takes free of certain defenses – to qualify, the transferee must, among other things, acquire a negotiable note in good faith and without notice of defenses

✓ **negotiability of mortgage notes:** if the note contains too detailed a reference to the terms of the mortgage securing it, the note may be non-negotiable because it’s no longer and “unconditional promise to pay a sum certain in money and no other promise”

✓ **acceleration clause:** makes the outstanding loan balance fully payable in the even the mortgagor fails to pay debt service or other financial obligations such as taxes and insurance payments, when due, or commits waste or any other act of default … if the note does not contain an acceleration clause, the courts will to imply one and the payee can only recover for sums past due. finding a waiver may be justified if the facts show that the lender’s acceptance misled the mortgagor. courts will typically enforce an express agreement providing for prepayment when the mortgagee accelerates because of the borrower’s default or b/c of an “involuntary” prepayment (condemnation). when there is no express provision, courts have generally barred mortgagees from charging a prepayment penalty when exercising an acceleration clause

✓ **strict foreclosure:** currently only in CT and VT. mortgagee, without a sale, is declared owner of the property, or if a sale was mandated he couldn’t bid, but got the proceeds and claim for the balance due … as time went on, it was supplanted in practically all states by foreclosure followed by public sale. it’s used for 2 purposes generally: (1) to cut off the interest of a junior encumbrancer whom the mortgagee mistakenly failed to join in foreclosure proceedings earlier brought against the mortgagor, or (2) courts sometimes allow it of equitable mortgages
judicial foreclosure: mortgagee can bid on the property himself and get deficiency judgments

necessary v. proper parties: a foreclosing first mortgagee can eliminate all encumbrances, liens, easements, covenants, leases and other interests that attached to the property after its mortgage. a junior encumbrancer can wipe out any interests that are junior to its own. but the title transferred on the junior’s foreclosure sale will necessarily be subject to any outstanding senior encumbrances. junior lienors are necessary parties in foreclosure by senior lienors who must be joined if their interests are to be eliminated and a completely effective foreclosure order rendered. necessary parties also include all easement holders, mechanics’ lienors and other whose interests first attached after the interest of the foreclosing lienor. failure to join necessary parties is that the redemptive rights they could have exercised at or before the foreclosure sale remain in tact. senior lienors are insulated from having to join in the junior’s foreclosure proceedings. they may be proper parties and can be joined without their consent if it would help.

foreclosure by power of sale: authority of the mortgagee to sell the property without court action, freed of the equity of redemption. power of sale, either in mortgages or deeds of trust, have developed in popularity … two necessary steps: notice and sale. notice dictated by local statute.

the rule against contemporaneous clogging of the equity of redemption is generally inapplicable to transactions subsequent to the original mortgage transaction … thus, most courts permit the mortgagee to purchase the mortgagor’s equity of redemption … but the transactions are subjected to careful review to ensure that it’s free from fraud, is based on an adequate consideration, and is subsequent to the mortgage and not contemporaneous with it

deed in lieu of foreclosure: transaction may be considered unfair and unconscionable, if the deed is not by the mortgagor but by a nonassuming grantee of the mortgagor a release of the debt (since there was no personal liability) would be no consideration for the conveyance to the mortgagee, courts may construe the deed in lieu as simply another mortgage transaction, deed in lieu does NOT cut off intervening liens and junior lienor may use the doctrine of merger to argue that the mortgage and redemption are now held by the first mortgagee destroying the first mortgage and advancing his position in priority (argument will seldom succeed)

advantages to lender: lender becomes owner and can control operation and obtain income of property, quick transaction, lender obtains marketable title, negative publicity, time, and expense of foreclosure is avoided, if structured correctly, not likely to be set aside in bankruptcy

advantages to borrower: obtain release of personal indebtedness under the mortgage, avoid negative foreclosure proceedings, lender might pay expenses of transfer, lender might grant limited possessory right to borrower

because right of redemption prior to foreclosure is cut off by a deed in lieu, the borrower might argue “clogging of the equity” – once a mortgage, always a mortgage – only if it was part of the mortgage transaction – subsequent, it’s not clogging

statutory redemption: statutory redemption is different from equity of redemption in that the former is established by the legislature, the latter by adjudication. 30 states allow it. periods run for about 1 year. in half those states, the debtor is unconditionally allowed to remain in possession … in others he’s allowed under special conditions (farming homestead) to remain in possession. split on whether redemption rights can be severed and transferred to 3d parties. courts may find a
valid redemption where there is only substantial compliance with the statute. A debtor’s waiver of redemption period will usually be subject to judicial scrutiny.

- **deficiency judgment**: deficiency includes very heavy costs of foreclosure, attorneys’ fees, court costs, masters’ fees, and fees of receiver and trustee. In addition to an outright prohibition on deficiency recoveries, a state may limit mortgagor liability by imposing fair value limitations, statutory redemption periods or procedural safeguards on sale.

- **one-form-of-action**: a mortgagee seeking enforcement of a real estate secured obligation must bring a foreclosure action the get a deficiency judgment... can’t proceed against the note, and then come back and proceed against the property.

- courts might set aside a foreclosure sale if the price is so low as to shock the conscience of the court

- **land sale K**: low equity arrangement for the purchase of real estate. It does not secure a loan or forbear the payment of money. It’s an installment sales K providing for periodic payments of the purchase price ... seller maintains legal title. Possession is not an automatic right of the purchaser, and must be provided for in the K. Seller may avoid foreclosure – he simply retains the installments and terminates the purchaser’s interest. Good device for low-income families – little or no down payment. Seller may convey the property to a bona fide 3d party purchaser, may maintain an action for waste, and his creditors can levy against his interest. Courts have also held the seller has an equitable lien on the property as security against the buyer’s nonperformance. To protect the vendee from forfeiture, courts will sometimes declare they’ve substantially performed or construe seller nonaction as waiver, or limit seller’s remedial alternatives to foreclosure of the vendor’s lien, or hold that the forfeited sum is an unlawful penalty. Buyer is in no position to demand marketable title until closing ... how protect himself? Buyer pay prior mortgagee or seller convey fee to buyer subject to the mortgage when the principal outstanding on the K equals the principal on mortgage. Also, notice-based recording acts protect him from subsequent mortgages ... he can record an acknowledgment memo

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**COMMERCIAL REAL ESTATE TRANSACTIONS**

- tax considerations
- 3 types of commercial real estate: (1) property held for investment or production of income, (2) property held primarily for sale to customers in the ordinary course of trade or business, (3) property used in trade or business

  - Crane and Tufts

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**COMMERCIAL LAND FINANCE**

- Most common lender strategy in fighting inflation has been to agree only to short term notes or notes renewable at specified intervals with the renewal rate adjusted up or down according to some measure of inflation such as the consumer price index
- Lender may agree to a long term loan, but only with a floating interest rate or a call provision
- Lenders might also participate in the income from the property (give a below market interest rate augmented by a specified percentage of the property’s rental income and appreciation at the end of the mortgage
- Participation of insurance cos. is waning.
- Pension funds and commercial banks have emerged as a potentially significant factor

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3 arrangements for assembling real estate debt and equity enjoyed varying popularity between the 1960s and 1980s – (1) limited partnership, (2) real estate investment trust, (3) joint venture.

1986 tax act also created REMICs (real estate mortgage investment conduits) to acquire and hold both commercial and residential mortgage loans and to issue securities embodying interests in these loans.

**Usury:**

**Wrap-around mortgages:** a second mortgage securing a promissory note, the face amount of which is the sum of the existing first mortgage liability plus the cash or equity advanced by the lender. The wrap-around borrower must make payments on the first mortgage debt to the wrap-around lender, who, as required by the wrap-around mortgage agreement, must in turn make payments on the first mortgage debt to the third party, the first mortgagee. If the wrap-around mortgagee should fail to perform his obligation to pay off the first mortgage, the wrap-around agreement normally gives the non-defaulting mortgagor the right to pay off the first mortgage, reducing his wrap-around obligation proportionately. The wrap-around mortgage lender not only earns on unadvanced funds but has a spread in interest on advance funds and additionally builds an equity.

**Reasons for wrap-arounds:** most are made to refinance and obtain additional proceeds – (1) where an existing mortgage is not prepayable, or the penalty for prepayment is burdensome, a wrap-around mortgage use in a refinancing leaves the existing mortgage undisturbed, (2) where the existing mortgage is on favorable terms as to may prepayment uneconomic, (3) reduces the cost of secondary financing, which commands a high rate because of the higher risk, (4) useful where mortgagee lending limits – statutory, regulatory, or self-imposed – limit the ability to obtain proceeds.

Wrap-arounds may cause usury problems because the lender is in effect receiving very high interest rates … the little law there is on the issue suggests that courts will in these circumstances pierce the loan’s formal structure and declare it usurious, unless of course the loan qualifies under some specific exception such as the corporate borrower exemption. The device is not sufficiently fool-proof to attract the more conservative institutional lenders.

**Construction finance:**

- Construction lender is usually a commercial bank primarily interested in making short term floating rate loans. He will advance the needed construction funds in stages over the course of construction, with its loan secured by a first lien mortgage on the property.
- Permanent lender: usually an insurance co. primarily interested in a long term loan, possibly with an equity participation feature. Takes out the construction mortgage upon the completion of construction by replacing the construction mortgage with a long term mortgage. Terms of the permanent loan are often embodied in the construction note and mortgage so that after construction the original note will pass from const. lender to perm. lender with no need for execution of a new note by a possibly recalcitrant borrower.
- **Construction loan:** value of the security depends on completion of the construction and realization of the projected economic value
  - Lender must be protected from unsatisfactory work, slow progress, violation of building codes, failure to administer subcontracts property, and misuse of funds advanced.
if construction is halted during foreclosure, weather damage, vandalism, and expense of recontracting and restarting will impose heavy penalties

- a bond on the contractor offers some in extremis protection, but requires prep. and comes at a high price
- bonding companies pay off carefully, slowly, and frequently only after a legal determination of their liability … bonds are like life ins., good if the project dies – they don’t substitute for first aid.
- bonds should not be placed in the loan agreement automatically – not the best protection for the lender

- draw inspector: to represent the lending source – an individual who in the construction practice who supervises payments by the lender, ensuring that the work claimed is actually completed, that it’s of good quality and complies with code restrictions and that the money advanced is applied to paying subcontractors and suppliers – serves as agent of the lender

- common causes of default: schedule of costs inadequate, advances to the developer are diverted to another use other than to pay the bills, defective work may present such serious difficulties that completion of the project becomes uneconomic, delays so serious as to increase costs of construction beyond hope for completing at a reasonable price, inadequate technical evaluation of plans (site problems, lack of utility services, intrusion on zoning requirements, failure to meet building codes, difficulties with access), excessive advances of the construction loan made in response to unjustified claims by the developer/contractor.

- protective measures in the loan agreement:
  - draw inspector (identification, duties, rights) – he should be a registered professional engineer, independent, with access to the contractor’s books, see all Ks and subKs, have prints and plans, correspondence, etc., with the power to withhold funds
  - retainage – provides for a percentage (10%) of the estimated cost of work in place to be withheld. provides the necessary cushion for uncertainties in estimating the value of work completed and in providing for unexpected deficiencies
  - lien waivers – protection for the owner/developer, but also necessary protection for the lender. include a description of the work done for the current claim, total amt paid to the recipient to date, amt. now claimed, amount of retainage, and a release for all work done and payments made to the date of the lien waiver … bookkeeping justification of all lien waivers received is therefore not needed and a complete picture is available with the current lien waiver. they serve to facilitate solution to many construction problems and also serve their ostensible purpose of freeing the property from the threat of mechanics’ liens

- obligatory and optional advances: traditional rule on mortgages securing future advances is that, if the advances are obligatory, they will enjoy the priority that attached to the mortgage when it was first recorded. if the advances are options or voluntary, they will enjoy the mortgage’s initial priority only if the mortgagee, when making the advance, had no notice of the intervening junior lien. courts have used it to rearrange priorities and achieve a fair result where a senior lender
makes advances in an unreasonable manner and injures the security of a junior lienor or mechanic. other courts approach lender behavior by just requiring good faith and fair dealing. and some courts reject an implied duty to monitor advances for the benefit of borrower or other lienors

✓ majority rule: subordinates the lien of the mortgagee’s subsequent optional advance only to the extent that the mortgagee had actual notice of the intervening lien before making the advance (must search the record)

✓ minority rule: requires only constructive notice to the mortgagee (must search title to avoid risk of losing the advance’s priority to the recorded lien)

✓ determining obligatory or optional: usually base disbursements on the project’s compliance with specified objective criteria

✓ advances to preserve collateral (taxes, ins. premiums, maintenance or repair, etc.) – some take the view that they’re “obligatory” in the sense that they’re necessary to protect previous loans and advances made by the mortgagee

✓ some states reject the obligatory/optional rule completely

✓ some have adopted “cut-off” notice provisions which permit the mortgagor to issue a notice which freezes advances having priority under the open end mortgage at their current amount

✓ **permanent loan**: without a permanent commitment most construction lenders will not make a construction loan. the construction lender and borrower would like to have the permanent lender bound to make the loan, with neither o them so bound until the time of the permanent closing – but this is unthinkable to a per. lender. he concerns himself with construction primarily because he wishes to be sure that the building to be constructed is the one on which he has committed himself to make a loan. he’s also concerned about construction b/c he will have a security interest in the building

✓ he may examine the plans and specifications in advance and order they be complied with b/c his appraisal is based on them

✓ interests of const. and perm. lenders are substantially the same: to have the building completed as provided for, to have their funds invested pursuant to their commitments, to have the construction loan paid upon completion of construction, to the perm. lender then hold the loan with the long-term security he contemplated when making his commitment

✓ perm. lender wants an agreement enforceable against all parties, including the borrower and the const. lender

✓ buy-sell agreements: in most cases a condition of the perm. lender’s commitment is the execution of a buy-sell agreement prior to the start of construction. 3 party agreement – with purpose of insuring that the permanent lender will buy the loan from the const. lender and that the const. lender will sell the loan to no one else. should include the following:

✓ consent of the perm. lender to the assignment of the borrower to the const. lender of the proceeds to be forthcoming under the perm. commitment

✓ agreement of const. lender to sell the loan to the perm. lender

✓ agreement of the perm. lender to buy the loan at part
✓ remedies in the event of the borrower’s default under the building loan agreement or under the perm. commitment
✓ agreement of borrower to comply with the perm. commitment and to amend the mortgage docs if the perm. lender requests it, and the agreement of the const. lender to obtain such amendments from borrower
✓ form of the promissory note and mortgage
✓ survey
✓ plans and specs for improvements (perm. lender must approve material changes from the original plans)
✓ evidence of ownership of property as reflected in a title policy … if the developer owns a leasehold, approval of the ground lease is required
✓ major tenant leases and standard lease forms, certificate of occupancy, architectural certifications
✓ form of various opinions required by the perm. lender with respect to compliance with environmental and zoning requirements
✓ advance approval of some items: before closing the const. loan, the const. lender will want approval of perm. lender on title, leases, appraisal, plans and specs. and the operating agreement.
✓ but at the time of const. loan closing, the perm. lender cannot know or approve the state of title for his purposes – he must reserve the right to reexamine
✓ also must reserve the right to reexamine the survey
✓ he may approve leases and operating agreements if they are in existence at the time of the const. loan closing, but this is unlikely
✓ other items the const. lender just has to take a risk on are the final survey, independent engineer’s report, estoppel certificates perm. lender may want from tenants and adjoining department stores, final title search, and executed leases
✓ courts have specifically enforced mortgage commitments against hesitant lenders on the theory that money damages are inadequate b/c of the unavailability of other funding or the time required to obtain a substitute loan
✓ where lenders bring actions from s.p. against borrower to close, court have generally denied s.p. b/c lender’s damages can be estimated with reasonable precision based on the difference b/t the commitment’s interest rate and the current interest rate.
✓ **subordinated purchase money financing**: sellers will often agree to subordinate their purchase money mortgages to the lien of the const. lender hoping the improvements will increase the value of land and the security interest … but also b/c subordination may be the only, or at least the most rewarding, way that they can sell their property for development since institutional lenders will rarely finance on the basis of other than a first lien security.
✓ **mechanics’ and materialmen’s liens**: actual physical improvement does not include architectural or engineering work, even though such work can be the basis for a valid const. lien. minority requirement, asserted by Uniform Const. Lien Act, states that the owner must record a “notice of commencement” prior
to the beginning of work – and this relieves the const. lenders from the burden of determining beforehand whether work has begun.

- mechanics’ lien practices vary widely from state to state – in some, the lien attaches on the commencement of const., others it attaches when a claim for payment is first filed, and in other it attaches when the general K is executed.
- if the security is exhausted by senior claims, equity may aid the mechanic by attaching a lien to any undisbursed const. funds … the supplier must show “special or peculiar equities” and that she relied on the availability of the const. loan funds.
- stop notice procedures: a lender or owner holding const. funds who fails to honor an unpaid supplier’s stop notice demand that it withhold sufficient funds to satisfy the supplier’s claim will be personally liable to the supplier for the amount owed.
- some courts hold that mechanics’ liens that attach after the const. mortgage was recorded be given priority over the claims of a const. lender who allowed the const. loan proceeds to be diverted from the const. project.

Leases

- ground leases/leasehold mortgages:
  - improvements on the land, called leasehold improvements, generally are owned or become owned by the lessee
  - if the land is unimproved, the lease ordinarily contemplates improvements to be constructed by the lessee
  - if the land is improved, the most common arrangements call for the lessee to either demolish the improvements and construct his own or to purchase the improvements as personal property severed from the land
  - ground leases are customarily “net” … the lessee pays for the maintenance of the improvements, all property taxes, fire insurance, etc.
  - long terms characterize ground leases – seldom less than 35 years
  - the needs and requirements, both legal and practical, of the institutional lender must be anticipated by both lessor and lessee
  - a ground lease is best understood not in lease or property terms but as a financing device
  - principal purpose is to hold the lessee’s cash investment to a minimum in order to maximize the ratio of anticipated return to dollars invested
  - lease may contain a provision to adjusting rental payments to keep pace with changes in the value of the leased property, the business, or the economy generally – “step up” clauses specify the amts and intervals by which rent will be increased
  - though most commonly used in leases with retail tenants, percentage rents can also be tailored to ground leases – a ground tenant who builds and operates an office building may agree to give his landlord a percentage of the gross rental he receives from his tenants
  - another way for landlords to reduce the effects of inflation is to shirt upkeep expenses from landlord to tenant. gross lease: one under which the landlord pays for repairs, maintenance, insurance, and real estate taxes. net lease: shifts some of these incidents to the tenant. triple net lease (bond lease): shifts all these incidents to tenant
  - if the premises are destroyed by fire, etc., the lease commonly terminates and the tenant will be compensated from the part of the award allocable to the value
of his leasehold and the value of the improvements, while the landlord will receive the rest.
✓ in the event of partial destruction, they may provide that the lease may be terminated at the election of either, the rent abated proportionately, or that the tenant will rebuild using the insurance proceeds.

✓ sale-leaseback:
✓ developer can minimize his equity in the property – normal loan to value ratios can be exceeded by use of a sale leaseback in addition to, or in conjunction with, a mortgage loan
✓ owner sells to an investor and simultaneously leases it back under a long-term net lease.
✓ the lease normally called for rent sufficient to enable the purchaser to recover its entire investment and to receive a satisfactory rate of return on the investment … although the entire return on the investment was taxable income, this disadvantage was offset by the purchaser’s ability to depreciate the improvements
✓ the corporate borrower obtained the benefit of 100% financing … the loss of the right to depreciate the improvements for tax purposes was offset by the right to deduct rent as a business expense. loss of use of the property at the end of the lease was a disadvantage – one that appeared more important when other forms of 100% financing became available
✓ but sometimes repurchase options are included
✓ courts and the IRS may find that the transaction is really an equitable mortgage rather than a true conveyance and true lease
✓ if this happens, and the lessee defaults, the lessor will not be able to evict by summary proceedings, but rather foreclosure
✓ may be subject to mortgage and intangible taxes
✓ transaction may become usurious – rent may be held to be interest payments
✓ to protect against this, the price at which the property may be reacquired should bear some reasonable relationship to its probable value at the time of repurchase

✓ distressed property/workouts:
✓ rather than immediately exercising its legal remedies, the lender of property in default often chooses to restructure the loan transaction in a way that ultimately allows the property to become self-sufficient … a workout.
✓ lender’s remedies: an assignment of rents can be activated in by the mortgagee’s serving notice on the tenants to pay their rents over … but tenants may react to the conflicting demands from owner and mortgagee by not paying rent to either until the issue is resolved in court. many courts are hesitant to pay rents to the mortgagee – they appoint a receiver- and even that can be hard to get done.

✓ bankruptcy:
✓ a debtor in possession may assume or reject executory contracts and leases.
✓ reorganization may be permitted over the objections of some creditors under the “cram down” provisions
✓ foreclosure is prevented
✓ reorganization begins with filing a petition for bankruptcy, then filing a reorganization plan (to classify claims, to specify treatment for each class of creditor, to provide in detail for the execution of the reorganization)
✓ only claims of the same legal character and rank and against eh same property are place in the same class
✓ for secured claims, 2 claims secured by a first mortgage claim and a second mortgage claim will fall into separate classes, as do mechanics’ liens
✓ 2 claims of the same kind and rank will be separate if they are secured by different property
✓ unsecured claims (deficiency claims, personal notes, accounts, K claims, etc.) are classed together regardless of form
✓ plan may either restructure debt to provide for extended payments or scale down the debt, reducing the debtor’s obligation
✓ then acceptances are solicited – holders of 2/3 of the total amount of the claims, and a majority of the total number of claimholders must assent to the plan
✓ regardless the court can confirm the plan (“cram down”) … but the debtor must request the cram down
✓ final step is execution of the plan
✓ **shopping centers:**
  ✓ economically dividing large parcels into useful segments, or staging
    ✓ the ground lease must provide that the tenant has the option to require the landlord simultaneously to cancel the lease and to execute two or more additional leases
    ✓ all new leased premises should be tied together with an easement agreement
    ✓ if the landlord will buy it, each of the separate leases will provide for a rent which bears the same proportion to the rent under the original lease as the area of the parcel demised by the new lease bears to the original demised premises
    ✓ if the landlord permits tenant to allocate rent in proportion to area, the most valuable parts of the original demised premises may be governed by a lease with an unrealistically low and unfair rent
    ✓ some common problems in staging: bringing utility services to the site, discharging sewage, effective design of traffic patterns
  ✓ every attempt should be made to provide in the lease that landlord will subject his fee interest in the demised premises to suitable easements for the necessary lines
  ✓ a government authority is not easily satisfied with a leasehold interest … they want to own the property – therefore, the lease should require landlord to convey it to the public authority free of the lien of the lease
✓ permanent lender’s closing docs:
  ✓ mortgage note (or endorsement from construction lender without recourse) (creates the debt obligation, describes the conditions under which the permanent lender is making the loan, and outlines the terms of default and the remedies available to the lender)
  ✓ mortgage deed of trust (secures the obligation created by the promissory note and outlines the terms of the security for the note … almost always provides that the sole recourse of the lender is to the property)
  ✓ loan agreement for continued disbursements (if the full amt of the loan is not to be made at the time of closing, an agreement outlining the conditions under which the additional disbursements will be made must be a part of the closing docs)
  ✓ assignment of tenant leases, rents, and profits to the perm. lender (borrower agrees to assign to the lender his interest in the leases, rents, and profits in the event he defaults under the terms of this assignment agreement or under the terms of the mortgage note, the mortgage, or the deed of trust)
✓ UCC security agreement and financing statement (perfect the lender’s right to possession of personal property used in connection with the operation of the real estate such as air-conditioning, cars, trust, service equipment, etc., in the event of a default under the note and mortgage … it’s a universal form.

✓ excusal agreement relieving principal from personal liability (limits the lender’s recourse in a default or foreclosure action to the real estate and excuses the borrower from personal liability

✓ an interest and amortization schedule

✓ perimeter survey must be examined and a title report reviewed

✓ building and occupancy permits have to be obtained

✓ title insurance

✓ perm. lender dictates the center’s financial structure and underlying legal arrangements

✓ developer’s primary financial objective – mortgage out the shopping center – obtain a nonrecourse loan for 100% or more of her land and development costs

✓ environmental regulation:

✓ CERCLA (Comprehensive Environmental Response, Compensation and Liability Act of 1980)

✓ potentially responsible parties include not only landowners, but also subsequent buyers

✓ negligence, intent, and comparative fault are irrelevant in determining liability

✓ the current owner will be strictly liable even though it had no role in the discharge, did not benefit from it, and did not own the land at the time the discharge occurred.

✓ the purchaser of contaminated land could not only lose his investment, he could also be required to pay out of pocket for clean up and response costs

✓ Superfund – established by Congress to finance response actions pursued by the federal government at those sites posing the greatest threat

✓ “owner and operator” is read “owner OR operator”

✓ some courts hold parties liable for passive disposal, others don’t

✓ lessees and lessors may be responsible parties

✓ where the harm is divisible, courts have held that joint and several liability does not apply

✓ responsible parties may seek contribution, but equitable contribution is not mandated

✓ innocent landowner defense nearly impossible to establish (maybe in an inheritance or bequest to children)

✓ due diligence inquiry:

✓ phase I: loan questionnaire, chain of title search, governmental records search, interviews of various parties, and the site inspection

✓ phase II: environmental audit (soil/groundwater sampling, surface inspection/testing)

✓ buyer of contaminated property may seek to hold seller responsible also under tort for abnormally dangerous activities on the land, public and private nuisance, mutual mistake, builder-vendor warranty

✓ buyers have enjoyed less success in claiming that the presence of hazardous materials breached promises relating to title

✓ environmental contaminations do not breach the implied warrant of marketable title and freedom from encumbrances

✓ insurance won’t get you out of CERCLA liability