The Basics of Contracts for Deed and Rent to Own Transactions

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In an era of depressed real estate values and tight credit markets, financing a real estate acquisition – be it single family residential, multi-family or commercial – requires more effort and creativity than in the recent past. With banks reluctant to lend money to people or for projects deemed "risky," buyers and sellers wanting to close a deal have had to resort to two tried and true methods of alternative financing: contracts for deed and rent to own arrangements.

Contracts for Deed

A contract for deed is the seller financed acquisition of real estate. Instead of a bank loaning the money to the buyer to pay the seller in full at a closing, the seller agrees to accept some amount of a down payment (to be negotiated between the parties) and periodic (usually monthly) installments of principal and interest for an agreed upon duration of time. Many contracts for deed cover a shorter period of time than the typical thirty year fixed rate mortgage, with a balloon payment due at the end of the contract term.

If all payments are made, the seller delivers a deed to the buyer at the end of the contract term that conveys the title to the property to the buyer.

If a buyer and seller desire to enter into such a contract, it is highly recommended that they use the uniform statutory form contract for deed (and applicable addenda). Furthermore, using an attorney to assist on the transaction is imperative due to the many legal requirements surrounding contracts for deed. Once signed, the contract for deed must be recorded with the county recording office.

The buyer on a contract for deed is said to own "equitable title" to the property. In the event that the buyer defaults on the payments under the contract for deed, the seller must follow a cancellation process set forth in Minnesota Statutes Section 559.21. This statute requires a sixty day written notice of cancellation be served upon the buyer. If the buyer objects to the grounds for cancellation, the buyer can proceed with a court action and an injunction to stop the cancellation from becoming effective. If the buyer takes no action, the contract is cancelled. The seller may retain any payments previously received by the buyer, and equitable title to the property reverts to the seller.

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Rent to Own

In a "rent to own" arrangement, the parties enter into a lease agreement for the property, together with an "option to purchase" agreement. (Or the parties can include the purchase option within the lease agreement itself.) Under this structure the landlord retains all title to the property, and the tenant pays monthly rent for a specified term. If the tenant remains current on his/her payments, the tenant has the right to purchase the property under the conditions in the "option to purchase" agreement.

It is important to note that when entering into a lease with an option to purchase, Minnesota courts do not enforce "agreements to agree." It is vitally important that the parties agree to all material terms of the purchase at the time the lease is entered into in order to avoid future uncertainty. It is highly recommended that the parties attach the purchase agreement to the lease or option to purchase agreement, as applicable.

Under Minnesota law, an option to purchase must be supported by valuable consideration (meaning that the party receiving the option must pay something to the party granting the option). While the facts and circumstances are the driving force behind determining what is a reasonable option price, it is a good practice to require payment of at least $1,000 from the tenant/optionee to the landlord/optionor.

Consequences for Associations

These types of transactions have significant implications for associations and association boards when the property is

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What are the legal mechanics of transitioning to resident control?
If a bank forecloses on a developer, who is in control?

Legal Q & A with Dan Greenstein, Esq.

Q If a bank forecloses on a developer who is still in control of a common interest community, who is in charge?

A Unfortunately, this type of situation is becoming very commonplace in our economic recession. Typically, when a real estate developer sets out to develop a common interest community, he takes out a loan from a bank to cover the cost of the project. If the developer becomes delinquent in payment on the loan or walks away from the project, the developer risks having the lender foreclose. When this occurs, the lender has a few options on how it may proceed:

The lender may decide to take over the developer's position as "Declarant" and continue to control the association. This means that the lender can foreclose and take a deed on the property, becoming the new Declarant. The lender can then appoint its own staff as representatives of the homeowners association and retain voting power. This situation may leave current homeowners with their hands tied until the Declarant required transition date.

A second option for the lender is to sell the land to a new developer who may take over the role as Declarant in control of the community association prior to the transition date. If this were to happen, the incoming developer would simply replace the former developer as Declarant and the project would continue until the date of transition. That's when the newly elected board of homeowners would obtain control of the common interest community.

The lender could also decide not to address the project or land and simply seek repayment from the original developer. If the bank decides to pursue this avenue, it can allow the original developer to remain in control of the project. But in this economy, this type of resolution is very unlikely.

We currently represent a number of partially built associations where the developer simply walked away. We have brought suits to gain immediate control of the association and to terminate any remaining period of Declarant control, so the owners can serve on the board. We expect the remaining land to be sold by the bank, and hopefully another builder will complete the project.

Q What are the legal mechanics of transitioning to resident control? (I haven't seen a clean one yet).

A A "transition" is the process by which the builder or developer, also called the Declarant, provides the newly elected board of association members with all information necessary to take over the control and responsibilities of the association. A transition may be compared to the sale of a business or the closing on a property. For example, when preparing to transfer a business, one must take account of everything associated with the business or anything that may reflect the business's current financial status. The ultimate goal of a transition is to successfully provide the members of the board with all applicable documents and information required to continue

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part of a CIC. First, most bylaws provide rights in the association to owners. If a unit is owned by a non-occupant, the association must provide dues statements and meeting notices to the owners (although some bylaws permit the owners to delegate these rights to the occupant of the unit), and care must be taken at any meeting to ensure that the proper person(s) are voting on a matter that comes before the owners.

Second, and more problematic, is the issue of a non-owner occupant acting in violation of the association's covenants and/or rules. Again, most standard association documents provide that the violation notices be provided to the owner. The practical problem, of course, is that the owner is not privy to the events or actions giving rise to the violation notice. It is therefore a better practice to notify both the owner and the occupant about any violation, and if a hearing is to be held in front of the board on the violation, invite both to attend.

Finally, with regard to leases with purchase options, care must be taken by the association manager and the board to check any applicable restrictions on leasing which are set forth in the association's covenants and rules. Very common examples of such restrictions are percentage limits on the number of units allowed to be leased and a requirement that the lease form being utilized must be submitted and approved by the association in advance. The latter measure ensures that a tenant's lease makes reference to and requires adherence to the association's covenants and rules.

Conclusion

Contracts for deed and rent to own arrangements are both attractive alternative financing arrangements for today's real estate market. Because of their increased popularity, association managers and association boards of directors need to be cognizant of the issues these arrangements present in terms of governance of the association and enforcement of covenants and rules. ■

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