



FARM COMMONS

# Financing Farmland with an Effective Land Contract: A Toolbox

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## UNDERSTANDING THE ESSENTIALS OF LAND CONTRACTS

## What Are Land Contracts?

A land contract is essentially a lease-to-own arrangement where the buyer makes installment payments over a period of time. Once the final payment is made, title to the land is transferred to the buyer.

**It's all in the name**

Land contracts are frequently referred to by many different names including contract for deed, installment land contract, long-term land contract, installment sale contract, bond for deed, and land sale contract. We're using the name land contract throughout this guide. Regardless of the name, the attributes are the same.

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There are really three phases to the land contract:

1. The negotiation phase.

The parties discuss and decide on a price and a timeline for when the buyer makes installment payments. They put all the terms of the deal in an agreement and sign it, which is the actual land contract.

2. Physical possession

The buyer takes physical possession of the land, often having to put little or nothing down. However, the seller retains legal title throughout this phase, which runs up until the buyer makes the final installment payment.

3. Transferring of legal title

After the buyer makes the final installment payment, the legal title transfers to the buyer. This is the third and final phase, and the buyer now officially owns the land.

Sometimes the timeline of land contracts covers a very long period of time, similar to a mortgage—15, 25, or 30 years. However, often the seller insists on a balloon payment at a particular time—often several years down the road—at which time the buyer must pay in full. If this is the case, the buyer may have to take out a loan or a mortgage to cover the balloon payment. Or, perhaps the farmer will have established a profitable farm operation by this time and will be able to afford the payment without a loan. That's the ideal scenario.

Even though the buyer does not have title to the land during the second phase of

the land contract, she is typically obligated to pay taxes, maintain the premises, and keep insurance. However, these are all things that can be negotiated between the buyer and the seller when crafting the land contract.

## What are the Benefits and Risks of Land Contracts?

### Land contracts are speedy, simple, and less costly

Land contracts are particularly attractive to beginning farmers who ultimately want permanent tenure in land but don't have a lot of capital and for whatever reason cannot qualify for an institutional loan. Land contracts are often much faster, easier, and less costly to finalize than land purchase transactions involving banks and mortgages. These are the essential benefits of land contracts. They don't require tons of upfront costs, including a large down payment, origination fees for a mortgage, or high closing costs. They basically take out the middle man—the institutional bank—and let the buyer and seller negotiate the deal themselves on their own time frame and their own terms.

“Land contracts are often much faster, easier, and less costly to finalize than land purchase transactions involving banks and mortgages.”

### The buyer risks losing everything on default

However, land contracts may carry significant risks for the buyer. The biggest risk of all is that land contracts typically include a forfeiture clause, which allows the seller to cancel the contract if the buyer defaults on the contract, which could include making a single late payment. This is a harsh consequence. If the buyer defaults and the seller terminates the contract, not only would the farmer-buyer lose her possession of the farmland, she would also lose all the previous payments she made. Imagine all that hard work and money spent enhancing the soil, maintaining farm buildings, building fences, learning the subtle nuances of the land in anticipation of owning it outright—all abruptly lost because of one late payment!

Oftentimes courts will step in and give the buyer time to cure the default, which we'll discuss more next, but the time period for correction can be as short as 30 days. Additionally, many states require the buyer to come up with the entire remaining balance owed on the land contract, not just the amount of the late payment, to reinstate her right to own the land.

### The buyer may face challenges in coming up with the balloon payment

Another key risk is the balloon payment that some land contracts require. Many people have lost their homes and land because they weren't able to come up with

“If the farmer-buyer doesn’t make the balloon payment at the time specified in the land contract, it would be considered a default and she risks losing the property and all the previous payments.”

this balloon payment. Five or more years may seem like a far off time to make such a payment, but it can come up surprisingly quickly. If the farm business doesn’t turn a profit or doesn’t go as well as planned, the farmer-buyer could have a hard time coming up with the money. If this is the case, the farmer-buyer will pretty much be back to square one—looking for a loan from an institutional lender to cover the balloon payment and having to “qualify” and pay added costs such as origination fees to secure the financing. And if the farmer-buyer doesn’t make the balloon payment at the time specified in the land contract, it would be considered a default and she risks losing the property and all the previous payments made.

**Can I take out a mortgage to pay my balloon payment?**

An increasing number of states are allowing a buyer to take out a mortgage on property to be owned under a land contract. However, the actual method in which the buyer takes a mortgage varies state by state. Farmers should be sure to check with specific state laws before taking out a mortgage on farmland subject to a land contract.

Of note, some states treat a land contract as a normal mortgage, which is explained in the next section. In these states, when a buyer takes out a mortgage on land subject to a land contract, the land contract is treated as the first mortgage and the mortgage that the buyer undertakes is treated as a second mortgage. Should the buyer default on either mortgage, the seller could foreclose on the property and the bank which held the second mortgage would be treated as a junior creditor, as the seller would have priority. This may make it challenging for a farmer-buyer to secure a mortgage to pay the balloon payment as institutional lenders prefer not to be second in line as a junior creditor and will most likely increase the interest rates or require other costs or restrictions in such a case. Keep this in mind when negotiating the timeframe of your land contract and be honest with yourself about the realities of making a future balloon payment.

**The buyer risks losing out on any improvements made to the land**

One other risk is that farmers often want to make improvements to the land right away, such as installing fences, renovating out buildings, or constructing a new packing shed. Unless the land contract adequately addresses what happens to these improvements upon a potential default, the farmer-buyer risks losing all the

“Farmer-buyers that intend to make changes or improvements to the property should pay careful attention and try to negotiate favorable terms for how these improvements are handled.”

costs incurred. Farmer-buyers that intend to make changes or improvements to the property before making all the required installment payments under the land contract should pay careful attention and try to negotiate favorable terms for how these improvements are handled. For example, the land contract could specify that the seller compensates the buyer for the improvements or it could establish a formula for determining how much the seller owes the buyer for the improvements upon default. Either way, farmers need to know the risks involved.

## Additional Protections for Buyers May Be Available

### **Some courts and legislatures and stepped in to address concerns over equity and fairness for the buyer**

Typically contract law carries the underlying principle of “freedom to contract,” which allows parties to decide whatever terms they want—within the confines of the law—and the courts will enforce the contract as written. An employment contract can’t, for example, say that the employee agrees not to accept minimum wage if the law requires employers to pay minimum wage, as that would be outside the confines of the law. But anything that is “legal” is typically fair game when parties sit down at the negotiating table. However, the land contract has become a unique kind of contract. Some states have put restrictions on forfeiture clauses that are written into land contracts based on principles of fairness or equity.

Some state courts and legislatures have stepped in to offer buyers using land contracts additional protection even though the parties have freely contracted and agreed to harsh forfeiture clauses. Another way of looking at it is that some courts and state legislatures think of the land contract as unique legal document given the extended timeframe and all that is at stake—an irreplaceable piece of land. They’ve basically said that in fairness to the buyer who has invested in and grown attached to the land, somewhere along the span of a land contract—during phase two—the title to the land “equitably converts” from the seller to the buyer. In effect, at this equitably manufactured point in time, the title is deemed to be no longer in the hands of the seller despite the fact the land contract says otherwise. This is what’s known as the equitable conversion doctrine. Once the title equitably converts in this way, the legal concepts of property override the contract terms calling for forfeiture.

Based on this reasoning, some courts and state legislatures have transformed

the land contract into something that is functionally similar to a lease or a mortgage. For example, by drawing upon mortgage law, some states grant the purchaser some or all of the protections enjoyed by people who bought land under a mortgage, such as the rights to reinstate the contract after default, to redeem property, to seek restitution of excess payments, and in some cases to demand foreclosure. This serves to reduce some of the risks farmers face in entering a land contract to purchase farmland.

**The parties are free to negotiate their own terms, but the courts may step in if the buyer defaults and the terms are not fair to the buyer**

As we discussed before, you can go ahead and negotiate and draft your own land contract as you want. That is always a helpful initial approach; going through the negotiation and drafting process itself can help clarify expectations, which ultimately helps prevent confusion, problems, and disputes down the road.

But let’s say things do go wrong. Despite all your intentions, you might want to go to court to resolve the dispute, and as we discussed, the court could do something different than you agreed. Some folks benefit from knowing beforehand what the court might do, just so they have it in the back of their minds. Others don’t want to know until things go down. If you are one of those people that wants to know, the following provides some general summaries of how forfeiture clauses in land contracts are handled in various states. For the curious farmer that wants to learn more about the legal idiosyncrasies of land contracts, be sure to read Section 5—*Why Are Land Contracts Treated Differently by the Courts*. Keep in mind that this is a state-specific area of law, and the details and differences by state are far too detailed and nuanced for this guide to cover. Farm Commons strongly recommends that farmers choosing to enter a land contract seek the advice of legal counsel in their state to more fully understand how forfeiture clauses are dealt with and to fully grasp the specific risks and processes involved.

**Equity of redemption—a grace period to reclaim the property upon default**

A number of states lessen the harsh nature of forfeiture clauses by allowing the buyer a “grace period” in the case of a default, during which she can pay the contract balance. In essence, once a buyer misses a payment, they can pay the remaining balance on the contract and obtain legal title, rather than entirely forfeiting their right to the property. States allow a grace period, usually between 30 and 90 days after the seller provides notice of default, during which the buyer

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can pay the balance owed in full. Some states additionally require that the buyer has established “substantial equity” in the property already (meaning that a significant number of payments have been made). Others states are even more specific and require that the past payments exceed the fair rental value of the land—basically they treat it as a lease-option scenario and say to the buyer, you essentially paid “rent” to use the land and you lose your option in buying the land when you default.

This safeguard is what courts refer to as the equity of redemption. It basically allows a grace period for the buyer to reclaim the property upon default. While the buyer must come up with a substantial payment to avoid forfeiture, this method does afford the buyer some additional protection in a final opportunity to fulfill the contract. The farmer will have anywhere between 30 and 90 days to pay the remaining balance owed and retain the property. Otherwise, she loses everything.

● **Equity of redemption** refers to the right given to a person who has taken out a mortgage to redeem the property subject to the mortgage by paying off the full debt. It prevents the lender from hastily taking or foreclosing on the property based on a late payment or default without giving the borrower a fair chance to pay off the debt.

**States allowing equity of redemption:** California, Florida, Hawaii, Missouri, Montana, South Dakota, Arizona, Iowa, Minnesota, North Dakota, Oregon, Texas, Washington.

### **Restitution to the buyer—an opportunity to get some payments back**

Other states offer less protection, but still allow the buyer to recoup part of the payments they have made to the seller. In these states, when the buyer misses a payment they still forfeit their interest in the land. However, the seller will be required to repay the buyer for all payments in excess of the buyers’ “actual damages.” Often courts will calculate damages as the fair rental value plus any repair costs. Let’s say for example that a farmers makes twenty monthly payments of \$500 under a land contract and isn’t able to come up with the twenty-first payment. The seller provides a notice of default. Based on the land contract, the farmer will not have any chance to pay the contract balance and will forfeit the \$10,000 in equity she has gained in the land. However, in states that allow restitution to the buyer, the farmer could recover anything above the fair rental value of the land. If the court determines that the fair rental value of the farmland is \$400 per month and the farmer did not damage the property, the seller will be forced to pay \$2000 back to the farmer. While this payment is a small consolation, it affords the farmer more protection than forfeiting all of the land.

● **Restitution** is a form of damages or judgment in a legal case where the proper owner of property or money is given back the monetary value of what was lost as a form of compensation. In this situation, the buyer of a land contract that has been deemed in default is given back the prior installment payments that were above and beyond rental value as restitution.

**States allowing for restitution to the buyer:** California, Alaska, New Hampshire, Hawaii, and Pennsylvania. Utah and Idaho also allow restitution, however, they require that payments made before default be “significant.”

**Treating a land contract as a mortgage** requires the seller to go through the timely and costly steps to formally foreclose on the property and provides the buyer a chance to redeem the land through the **equity of redemption**.

### **Treatment as a mortgage—requiring the seller to foreclose on the property**

A growing number of states are giving buyers under land contracts greater protection by transforming land contracts into mortgages in certain situations and giving the buyer all the rights and privileges of a mortgagor. For example, many state laws allow the buyer to retain the right of redemption so long as she has made “more than nominal” payments on the land contract. The equity of redemption is the right granted to the debtor whose property has been foreclosed upon to reclaim the property if they are able to come up with the money to repay the debt. However, if the buyer cannot pay the contract balance within the statutory period (typically between 30 to 90 days), the land will be subject to a foreclosure sale. Under this scenario, the normal mortgage laws apply, meaning that the purchaser can still pay the balance owed on the land until the date of the foreclosure sale. Also, just like a traditional mortgage foreclosure, if the property sells at a higher price than the land contract price, the buyer retains the surplus. However, if the land sells for less, the seller can bring suit against the buyer for the difference.

For example, let’s say that Gene entered a land contract with Chris for \$100,000. The land contract has a forfeiture clause that specifies that Chris gets to keep all the payments upon default and that Gene loses out on buying the property. Over a span of eight years, Gene makes 80 payments of \$1,000 each. He then fails to make the 81<sup>st</sup> payment, so Chris enters a notice of default. In the states that transform land contracts into mortgages upon a default, instead of automatic forfeiture, the mortgage laws would now automatically kick in. This forces Chris to go through the foreclosure process and file all the necessary paperwork to foreclose on the land to preserve his rights to the land. If Chris starts the foreclosure process, Gene then has a set period of time under his right of redemption to come up with the \$20,000—usually somewhere between 30 to 90 days. If Gene does so before the foreclosure sale, the property is his. Let’s say Gene doesn’t come up with the money and the property goes to judicial auction on the court house steps. If the property sells for \$104,000, Gene would get the \$4,000 surplus. However, if the property sold for \$96,000, Chris could sue Gene to recover the \$6,000 loss.

As this example illustrates, treating the land contract as a mortgage provides

the buyer the greatest degree of protection. Upon default, the onus is really on the seller to preserve his interest in the land. If the seller does nothing, the land contract is still in place and if the buyer continues to make payments the land will ultimately be his.

“Identifying the objectives of the parties and thinking through how to best handle the worst-case scenarios and possibilities is vital in ensuring that the land contract will serve the interest of both the buyer and seller.”

While this is all good news for farmers who want to purchase land under a land contract, the backlash is that in such states, sellers are becoming more reluctant to enter land contracts with buyers that would not ordinarily qualify for a mortgage. They fear that they will end up having to go through the time and expense to engage in the drawn-out mortgage process to get their land back upon a default, which is more likely for a buyer without good credit or for whatever reason is not able to “qualify” for a traditional mortgage. Nevertheless, if a farmer can find a seller that is still willing to enter a land contract despite this, it can be an ideal scenario.

**States treating land contracts as mortgages:** Indiana, Kentucky, Maryland, and Oklahoma. Ohio treats land contracts as mortgages as long as the contract is at least five years old and 20% of the principal has been paid. Additionally, courts in Nebraska, New York, Florida, and California are moving in the direction of treating land contracts as mortgages—allowing purchasers many, but not all, of the protections.

**Mortgage foreclosure procedure:** All states have slightly different foreclosure laws, but in general they follow a similar procedure:

- The seller files suit in court.
- Buyer receives notice in the mail demanding payment.
- Buyer must respond within 30 days with payment in order to avoid foreclosure.
- If payment is not made after a certain time period, the mortgaged property is then sold through judicial auction.

## The Importance of Creating a Customized Land Contract

Identifying the objectives of the parties and thinking through how to best handle the worst-case scenarios and possibilities is vital in ensuring that the land contract will serve the interest of both the buyer and seller. While the courts may step in

upon a default to override a harsh forfeiture clause, the parties can avoid a lot of this potential mess by taking time to understand the laws of their state for land contracts and to customize the land contract to meet both of their needs.

Of course, an essential component to a successful land contract situation is to do everything you can to not default on the contract. Regardless of how the state treats the forfeiture clause, a default pretty much opens a can of legal worms. You'll be asked to explain how you followed the contract to the letter and why you deserve greater protection. Therefore, be sure to really think through the timeline and carefully and conservatively crunch the numbers of your farm operation before signing a land contract. A smart business plan and financial analysis can help you stay out of trouble and ensure that the land contract plays out to its full potential by providing you permanent tenure to your dream piece of farmland. This includes preparing a monthly cash flow analysis to help give you an accurate sense of whether you'll have enough cash to make due on the payments year round, especially during the off season.

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## How to Use This Guide

Farm Commons focuses on creating flexible, adaptable tools that empower farmers to move forward in addressing their legal matters. Farmers (and business owners of all types) are sometimes under the misimpression that legal matters can be addressed by simply using the “correct” form or language. This often isn't the case. This toolbox is designed primarily to help farmers build their own strategy to avoid legal problems through good communication, which is also good legal protection should a problem materialize. This toolbox IS NOT legal advice specific to any circumstance and should not be used as such.

The tools we provide are meant to help farmers who are seeking alternative ways to finance farmland—by not having to go through an institutional bank. It is also helpful for farmers who are in the process of negotiating or creating a land contract with a willing seller. The checklist and sample land contract contain a variety of options to help farmers craft provisions that are most suitable to their specific situation. The story about the purchase and sale of farmland between farmer Clair (buyer) and Penny (seller) using a land contract is woven throughout to highlight the key issues that arise in land contracts and illustrate the importance of negotiating the terms up front.

For farmers that are curious about the peculiar nature of land contracts and want to learn more about why state courts and legislatures have gotten so involved, be sure to read Section 5– *Why Are Land Contracts Treated Differently by the Courts?* Given land contracts are a very state specific area of law, Farm Commons highly recommends that farmers entering land contracts work with an attorney in their state to either help draft or review the final land contract.

**After opening this toolbox, farmers should:**

1. Understand the potential attributes for using a land contract to finance farmland.
2. Know the basic elements of a thorough land contract.
3. Gain a sense of how to adapt land contract elements for different situations.
4. Have the resources they need to negotiate and begin to create a land contract adapted to their own unique situation.

## STORY OF A LAND CONTRACT

## Serendipitous Meeting of Penny and Farmer Claire

Penny Gordon swore to herself that she was not going to be a farmer. Growing up on a 20-acre farm right outside the center of town in Zinc, Sun State, Penny longed for the minute she could escape to college and leave her rural roots behind. And for a while, she did exactly that. Penny worked in a bustling city as a marketing manager for 25 years before the death of her parents brought her back to Zinc. Dragging Mark, her urban-raised husband reluctantly along, Penny returned to her inheritance and threw herself into the world of farming with a fierce desire to continue her parents' legacy and preserve their vision of Zinnia Farm.

After a few years, tensions were high between Penny and Mark. Mark was not charmed by the rural way of life, nor the cold and blustery winters that Zinc was known for. Penny and Mark had a son who lived with his wife in sunny Calisun. One day, their son called up to give his parents the exciting news that they could expect a grandchild in the coming year. Penny and Mark decided that the time was right to make the move to Calisun to repair their marriage and be there while their grandchild was growing up. But, before they can take off, Penny has to figure out what to do with her land and Zinnia farm.

One day, Penny is at the local co-op chatting with some other farmers about her dilemma: she wants to move off the land, but it's important to her to ensure that Zinnia Farm will continue to prosper in the hands of passionate and caring farmers, as her parents would have wanted. A co-op customer, Claire O'Conner, overhears this conversation and can't believe her luck. She and her husband, Frank, had just decided the week prior to pursue their dream of starting a small produce farm and CSA and begin the search for a suitable piece of land.

Penny and Claire started talking and immediately hit it off. Claire voices her only concern: she isn't sure that she and Frank have good enough credit to obtain a mortgage from the bank to buy land. One of the other farmers tells Penny and Claire about an option that they had never heard of before: a land contract. The farmer describes the land contract, also known as a contract for deed, as a financing strategy similar to a mortgage, but leaving the bank out of it. It's a way for a buyer to take the physical possession of the land while the seller retains the legal title. The buyer makes installment payments to the seller until the contract is fully paid—at that time legal title transfers to the buyer.

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Where is Sun State? This story and the accompanying agreement are not written for any particular state. Please use this as a general example and look into your state's laws to move forward with your own land contract.

The concept of a land contract appeals to both Penny and Claire. Claire realizes that this is the best way for her and Frank to manifest their farming dreams, and Penny likes the idea of getting monthly income from the “rent” for her land while resting assured that the farm is in good hands. One potential downside for Penny is that some of her money would be locked up in the land as the O’Connors pay off the contract, but she and her husband are planning on moving in with their son and wouldn’t need the capital to purchase a new home. Penny and Claire exchange information and make a date for the O’Connors to come check out the property.

## Negotiation of a Land Contract Deal

When Penny goes home she is excited to share the news with Mark. But, he’s not as enthusiastic as she is about the arrangement. He doesn’t know too much about the way land contracts work and is worried about the potential for the O’Connors to take advantage of the situation. He suggests they talk to an attorney to figure out the best way to move forward and set up the land contract.

By the time of the farm visit, both Penny and the O’Connors have done their research. After a successful farm tour that has Frank and Claire excited to move forward, they all sit down with a sample contract that Claire had found online for them to use as their blueprint. The plan is for them to hash out the details and then have Penny’s attorney review their drafted contract.

### **Purchase price and repayment terms**

Up first for discussion is the purchase price of the land. Penny suggests that they use the fair market value of the land by looking at what comparable land has sold for in the area. Penny had already gotten this information from a real estate agent. Claire and Frank agree to pay \$100,000 for the land and home. They also agree to pay a 10% down payment to Penny of \$10,000 when they sign the contract. This will be a stretch for them, but they’d like to pay as much upfront as possible because any down payment is deducted from the principal of the loan and means no interest will accrue on that amount. This means after their down payment, the loan will actually be for \$90,000.

Next, discussion turns to how the loan will be paid back. From her research, Claire knows that there are at least three different options for paying back the loan: (1) monthly installments with interest, (2) monthly installments without interest and (3)

“Penny suggests that they use the fair market value of the land by looking at what comparable land has sold for in the area.”

balloon payment. Penny is upfront about her desire to charge a 2% interest rate, which takes option two off the table. Of course, Frank and Claire would ideally like no interest charges, but they know they've lucked out with this arrangement and are willing to pay Penny what they consider to be a reasonable interest rate.

The balloon payment option makes Frank and Claire a bit nervous. A balloon payment means that Frank and Claire would make even monthly payments but at the end of a set time period, such as five years, they would have to make a lump sum payment to Penny for the total amount due. Frank and Claire know that if they do this option, they would have to get a mortgage to pay the remainder of the loan. If they couldn't get a loan for the lump sum (which is a concern because of their credit backgrounds), they could lose all interest in the land.

While option two clearly favors the purchasers and option three favors the vendor, the group decides to choose option one, monthly payments with interest, which is the most equitable for both parties. Under this arrangement, Claire and Frank will pay back the loan with monthly installments that include the loan amount plus 2%. This payment type is almost identical to a mortgage.

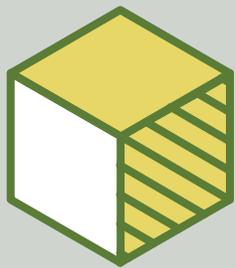
“Under this arrangement, Claire and Frank will pay back the loan with monthly installments that include the loan amount plus 2%—which is almost identical to a mortgage.”

### **Prepayment option**

Claire and Frank bring up the potential of prepayment on the remainder of the loan. There is a chance they'll come into a large sum of money in the future from a possible inheritance, and they want to know if they'll be able to prepay the loan without penalty and obtain the title to the land earlier. Penny is concerned about the tax consequences of receiving a large unexpected payment, but Frank suggests that although there will be a tax hit, potentially getting the entire sum at once and being done with loan could be beneficial enough to outweigh that cost. Penny likes the idea of getting the money earlier and being able to help her son with the expenses that go along with having a child (as well as maybe surprising Mark with a romantic second honeymoon!) She decides she will talk to the attorney or her accountant about the tax implications from prepayment before they finalize the contract, but she is open to the idea of allowing prepayment whenever Claire and Frank are able to pay.

### **Next steps**

With these main details discussed, Penny is ready to bring the adapted sample contract to her attorney for review. Frank and Claire begin to plan for their dream farm, and Penny and Mark call up their son to tell him to expect them out in Calisun in the coming months.



# Checklist: Negotiate and Create a Land Contract

## Using This Checklist

This checklist outlines issues that land owners and farmers should thoroughly and thoughtfully consider when entering a land contract. Going through this checklist and answering the tough questions will be of great benefit to all parties involved. This brainstorming and negotiation process can help clarify how various scenarios will be handled, set shared expectations, and prevent confusion and disputes.

The next step is to get everything in writing in an official agreement. We're using "land contract" here to generically refer to the agreement entered to govern the arrangement of a long term land sale. However, this type of legal agreement goes by many names depending on the state, including contract for deed, installment land contract, installment sale contract, bond for deed, land sale contract, and so on. It's best to use the name that is recognized in your state, so be sure to research what is custom and generally accepted there.

Farmers can certainly try drafting a land contract themselves. However, the drafting process can be challenging and may not be the best use of a farmer's limited time. The other option is to bring your responses and thoughts to the issues and questions in this checklist to a qualified attorney. He or she should be able to assemble a terrific land contract that is consistent with the laws of your state with this information. By doing the legwork, you will make the process much more efficient for the attorney and less expensive for you.

This checklist is designed to be used with our other resources provided in this toolkit, including the *Essentials of Land Contracts* and the *Sample Land Contract* that dovetails with the story of the land contract deal between the Gordons (the buyers) and the O'Connors (the sellers).

If you choose to draft the contract yourself, the sample Land Contract following this section has sample provisions and various alternatives which can help guide you through this process. Keep in mind that land contracts are quite peculiar compared to other legal contracts. In particular, a court may actually interfere and interpret certain sections—particularly the forfeiture clause which designates what happens if the buyer fails to make an installment payment on time—differently than what is written in the contract. For more details on this oddity, review the special legal issue section at the end of this toolkit— *Why Are Land Contracts Treated Differently by the Courts?*

“The brainstorming and negotiation process can help clarify how various scenarios will be handled, set shared expectations, and prevent confusion and disputes.”

## Summary Checklist

- How much is the purchase price?
- Does the buyer have to pay any money upfront?
- How long does the land contract run?
- What are the terms of the payments?
  - How often are payments made?
  - Will interest be charged and, if so, how much?
  - Will there be a balloon payment?
  - Is prepayment allowed?
  - How exactly must payments be made?
- What happens if the buyer fails to make payments on time?
- What happens to the improvements made by the buyer if the contract is terminated?
- Who pays for property taxes?
- Who pays for insurance?
- Who is responsible for damage to the property?
- What happens if someone is injured on the land or equipment is stolen?
- What happens if the land is condemned or the government takes the land?
- What happens if a party doesn't pay the bills when they're supposed to?
- Can the buyer sale or lease the land to someone else?

“Sellers face a level of risk in entering a land contract with a buyer that may not otherwise qualify for a traditional loan, so they may insist on a higher purchase price than the going market rate.”

## Checklist with Explanations

- How much is the purchase price?

This is obviously a fundamental term that the parties will need to negotiate. How much will the farmland ultimately cost? Sellers face a level of risk in entering a land contract with a buyer that may not otherwise qualify for a traditional loan or mortgage, so they may insist on a higher purchase price than the going market rate. A higher price can be fair to some degree as the farmer benefits from the opportunity to secure permanent tenure on a piece of land even though she might not have good credit or a lot of money in the bank.

Nevertheless, farmers should do their homework and research prices of

comparable land in the area. This gives the farmer-buyer some ammunition to negotiate a fairer price and prevent the seller from unduly taking advantage of a less-than-stellar financial situation. You can find this information by searching online listings such as Zillow or calling a local realtor who will have access to the purchase prices of similar land sold in your area within the last year or so.

 Does the buyer have to pay any money upfront?

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 “One advantage of a land contract is that oftentimes sellers do not require the buyer to pay any money up front.”  
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The benefit of making a down payment is that it immediately reduces the principal—or the amount of the purchase price less any interest that accrues. So if the buyer puts \$20,000 down on a \$100,000 purchase price, she’ll only have to make the monthly installment payments on the remaining \$80,000. If the seller requires an interest rate to be paid on that remaining balance over time, it can really add up. However, many farmers don’t have a lot of money up front, so a high down payment may not be an option. One advantage of a land contract is that oftentimes sellers do not require the buyer to pay any money up front. With that said, even if the farmer does have a lot of money and could make a substantial down payment, she may instead want to keep this cash on hand to pay for other capital expenditures such as equipment that will help grow the farm business. While farmers often want to minimize taking on debt, having some debt that can be stretched out over time can serve to free up cash flow early on. This is something both the farmer and the seller will have to consider and negotiate to come up with the best solution based on their situation.

 How long does the contract run?

The land contract could last for as long or as short as the parties agree to. Note that the longer the contract runs, the less each installment payment will be as it will be stretched out over time; however, the longer it runs, the more time it will take for the buyer to receive title and own the land outright and the more interest charges will accrue if applicable.

 What are the terms of the payments?

How and when the payments are made are fundamental issues that need to be addressed. This includes several components, which the following questions outline:

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 “One way of thinking about interest charges is that they are the cost for the opportunity to secure permanent tenure in land over a period of time.”  
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- How often are payments made?

The parties will need to decide how often payments are made—bi-monthly (i.e. every two weeks), monthly, quarterly, annually, or something else? Farm operations are inherently seasonal so cash flow will most likely vary in different parts of the year—typically more cash comes through late summer and less comes in through late winter. Farmer-buyers should carefully consider their financial situation and ideally prepare a monthly cash flow analysis to be sure they will be able to make all monthly payments on time throughout various stages of the year. If it becomes apparent that making payments in a given month or time of year—such as December or January—will be an issue, the farmer-buyer can try to negotiate another arrangement such as quarterly or annual payments.

- Will interest be charged and if so how much?

In addition, the parties will need to negotiate whether interest is charged and if so what the interest rate will be. Zero interest charges is definitely the best scenario for the farmer-buyer. However, it may be challenging to find a seller who is willing to agree to it. Keep in mind that any interest that is charged will increase the money owed throughout the term of the contract, which will exceed the purchase price. Let’s say the parties agree to a \$100,000 purchase price that will be paid over a period of 10 years with monthly installment payments at 2% interest per year. Let’s also say that the farmer-buyer pays \$10,000 as a down payment so the principal balance is \$90,000. Ultimately, the farmer-buyer will pay a total of \$109,908 through 120 monthly payments over the course of the contract. This is in addition to the \$10,000 down. So while the purchase price is \$100,000, the farmer will have to fork out \$119,908!

One way of thinking about interest charges is that they are the cost for the opportunity to secure permanent tenure in land over a period of time. It’s really the same for a mortgage. So unless you can pay cash for the property up front, you’re pretty much in the same boat for both. Nevertheless, a keen farmer-buyer should pay attention to the going market interest rates, which are generally posted by all major banks in your area. It can be helpful to take these rates to the seller to negotiate a fairer rate. Also, interest rate calculators are available on line which can help calculate what your monthly payments would be based on various interest rates, the principal amount, and the time frame of the contract. Simply search “mortgage calculator” or “interest rate calculator.”

- Will the buyer be required to pay a large lump sum at the end of the contract?

A large final payment is often referred to as a balloon payment. Under this scenario, the buyer makes even monthly payments for a period of time—say two, five, or ten years—and then the buyer is required to make a lump sum payment for the total amount due at the end of the contract term. Entering this kind of arrangement has its advantages as depending on how its all set up, the installment payments could be smaller. For example, let's say the the parties agree to a five-year contract with a \$100,000 purchase price. The buyer agrees to make 59 monthly installment payments at \$500 equating to \$29,500. Then, final payment is the balloon payment that must be made on that 60<sup>th</sup> month. This balloon payment will cover the balance of \$70,500. Without this balloon payment, the buyer would have to make 60 equal monthly installment payments which would be \$1667. This is quite a difference! Note that for simplicity sake, these calculations all assume there's no interest charges. If an interest rate applies on the payments, it would be even more as explained above.

Farmer-buyers may be tempted to enter an arrangement that include a balloon payment to keep the initial payments low. However, be cautious when committing to make a huge balloon payment. Five or even ten years down the road may seem like a long time, but anything could happen. What if the farm operation isn't as successful as you thought it would be and isn't turning a profit and for whatever reason can't qualify for a loan?

If a balloon payment is required, the buyer will often need to secure funding to make the payment when due, which may include taking out a mortgage on the property if the state laws permit it or a taking out personal loan. Note that some states allow buyers to take out a mortgage on land that is subject to a land contract and some don't. Be sure to check your state's laws before considering this option. In any case, if the farmer-buyer can't come up with the balloon payment on her own, the buyer will be back to square one and have to "qualify" and abide by the terms of the mortgage or even a personal loan. Also, depending on the forfeiture clause in the land contract as well as state law protections, if the farmer-buyer is not able to come up with the lump sum or secure financing when the balloon payment comes due, the farmer-buyer may forfeit all of her rights to own the land and could lose all of the prior payments.

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 "Be cautious when committing to make a huge balloon payment. Five or even ten years down the road may seem like a long time, but anything could happen."  
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- **Is prepayment permitted?**

Whether the buyer can prepay all or a portion of the purchase price before the amount is actually due is an important consideration. Remember, until or unless the buyer pays in full, the title to the land is in the hands of the seller. During this time, the interest charges can tally up quickly. Imagine you inherit some money in year two and want to pay off the entire balance so you can own the land right away—or even pay off a large chunk so you can own the land earlier.

Provisions in the land contract allowing prepayment without penalty is common these days and it is also the most advantageous option for the buyer. However, sometimes sellers are concerned that receiving a large payment at once might increase their tax basis in a given year. If this is the case, the seller may want to either prohibit prepayment or charge a penalty if and when a prepayment is made. With that said, most sellers prefer to have the cash upfront, as having the cash on hand outweighs their concerns about the tax consequences. Whether prepayment is permitted and whether there's a penalty for doing so is something the parties will have to negotiate based on their specific situation.

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 “Payment is a vital aspect of the deal, and the clearer and more specific this is all set forth in the land contract the better.”  
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- **How exactly must payments be made?**

The contract should clearly specify how the payments are made when they are due. Are they due on the 1<sup>st</sup> of the month? Does this mean they have to be in the seller's hands by the 1<sup>st</sup> or can the payment be postmarked by this date? In what form must the payments be made—personal check, cash, cashiers check, or anything else? Where must the payments be sent—the seller's mailing address, dropped off at a particular place or handed to the seller in person, etc.? Payment is a vital aspect of the deal, and the clearer and more specific this is all set forth in the land contract the better.

☞ **What happens if the buyer fails to make a payment on time?**

The land contract should clearly outline what happens if the buyer makes a late payment or otherwise fails to abide by the terms of the agreement such as maintaining insurance or not properly maintaining the land. In legal speak, this is called a “default.” As a caveat, provisions in land contracts that outline what happens if the buyer is in default may or may not be enforced by the courts in your state. This is because historically land contracts came with harsh consequences— if the buyer was in default, the seller could terminate the contract and retain possession of the land as well as all of the buyer's prior payments. Basically, the buyer would forfeit everything! This explains why the provision in the land contract dealing with the buyer's default is often referred to as a “forfeiture clause.”

“The parties can certainly agree on how they prefer to handle the critical issue of the buyer’s potential default while knowing that the courts may or may not enforce their preference as written in the land contract.”

### Courts and state legislatures may step in and override forfeiture clauses

Recently courts and state legislatures have stepped in and, despite what the contract says, offer buyers using land contracts additional protection based on fairness and equity. Indeed, this can be a huge benefit to buyers who undertake a lot of risk when entering a land contract. Note that this is an area of very state-specific law, which is far too detailed and nuanced for this guide to cover state by state. However, in *Overview of Land Contracts* we outline some of the various ways courts deal with this issue. Be sure to review that section of this guide to fully grasp the specific risks and processes involved should the farmer-buyer miss a payment or otherwise breach a term of the land contract. To gain an even deeper understanding of the issue, be sure to read the special legal issue section at the end of this toolbox– *Why Are Land Contracts Treated Differently by the Courts?*

The basic takeaway is that the parties can certainly agree on how they prefer to handle the critical issue of the buyer’s potential default while knowing that the courts may or may not enforce their preference as written in the land contract. This may seem strange. However, going through the negotiation and drafting process itself can help clarify expectations. This ultimately helps prevent confusion, problems, and disputes down the road. With that said, if you want the most accurate picture and the most control over your situation now and into the future, speak with an attorney whose familiar with the laws in your state for details.

There are three main ways that courts will deal with forfeiture clauses or how the land contract handles the buyer’s default. The first is that courts treat the land contract as a mortgage. This provide the buyer the most protection. The seller has to go through the long and costly process of foreclosure and the buyer is given the same rights as someone who buys land through a mortgage, including an opportunity to make the payment in full before a specified grace period to redeem or get the property back. This is called the equity of redemption in legal speak. The second way courts treat this issue is by just giving the buyer this equity of redemption, but they don’t require the seller to go through the full process of foreclosure. The third is what’s called restitution to the buyer. This provides an opportunity for the buyer to get some of the prior installment payments back but doesn’t allow the buyer to reclaim the property. Yet another option would be to

have a traditional forfeiture clause, which says the buyer forfeits everything if she fails to make a payment on time or otherwise defaults on the contract. Farmer-buyers should NOT agree to this! It carries very harsh consequences—losing everything including all prior payments for a single late payment. Nevertheless, as just discussed, traditional forfeiture clauses are not enforced in most states, so the buyer will likely have some protection even if a forfeiture clause makes its way into the land contract.

While the best option is for parties to find out how their state handles this issue, the parties can choose whichever approach they prefer or even negotiate their own term in the land contract. We’ve included a sample provision for each in the sample land contract that follows. You can choose any of these provisions, or something else that is more specific to your needs. Keep in mind that no matter what you choose a court could disregard it entirely and apply a different set of rules and remedies.

“The parties should decide upfront whether improvements are permitted and, if so, how they are handled.”

#### ☞ How are improvements made by the buyer handled?

Improvements to the land include permanent changes such as installing fences, renovating out buildings, or constructing a new packing shed. The parties should decide upfront whether such improvements are permitted and if so, how they are handled. Are they allowed outright, or must the buyer first get the seller’s permission? What happens if the contract is terminated or if the buyer defaults? Does the buyer get to take the improvements with her if they are moveable? If not, does the seller compensate her in some way for all or part of the cost in making the improvements? Farmers often want to make improvements to the land right away and not have to wait until they own the land, which could be 10 or 20 years down the road. Unless the land contract adequately addresses what happens to these improvements upon termination of the contract based on default or something else, the farmer-buyer risks losing all the costs incurred, including blood, sweat, and tears.

#### ☞ Who pays for property taxes?

Typically, in land contracts, the buyer must pay the property taxes and assessments on the land. However, this issue can certainly be negotiated between the parties. Either way, the land contract should specify who is responsible for covering this obligation. It can cause serious issues in the form of monetary penalties by the county if both parties assume the other is responsible and neither party pays. This is one condition that differentiates a land contract from a rent-to-own scenario. Typically, tenants do not pay property taxes while buyers under a

land contract do. But again, these terms can be negotiated between the parties.

☞ Who pays for insurance and what are the minimum requirements?

Just like property taxes and assessments, typically the buyer under a land contract is responsible for maintaining and paying for insurance throughout the duration of the contract. But who pays is not the only issue. Land contracts should clearly outline what the minimum coverage is and what types of policies are required—property, general liability, and so forth, in addition to what must be covered.

For example, must the property insurance cover floods and earthquakes? Most contracts will require that you get insurance in the amount of the full replacement value of the land, including buildings, improvements, and fixtures.

Insurance under a land contract is a bit of a paradox. While the buyer pays for the insurance, the proceeds will generally go to the seller who is the legal owner of the land until the final payment is made and the title is officially transferred. The legal contract should therefore clearly outline what happens to any insurance proceeds if and when they are recovered. Does the buyer have some control over how they are spent, or can the seller run off to use them to fund a European vacation? The sample land contract provides a creative way to handle insurance proceeds for property damage. It basically allows the buyer to use the proceeds to make repairs if the seller approves. Otherwise, the funds must be applied toward the purchase price. Either way, it protects the buyer's vested interest in the land. This is just one option that you can use to get your creative juices flowing. It's up to the parties to negotiate and agree what is best for them.

☞ What happens if someone is injured on the land or equipment is stolen?

What happens if someone, such as a visitor or an employee, is injured on the land? Or if the farm equipment is stolen? Given the buyer is in possession of the land, she will most likely be deemed responsible for injuries, stolen property, or other unfortunate occurrences that occur on the land. This is the case even though the seller still owns title to the land. The land contract could be written in such a way where the buyer and seller share the risk and liability based on their own fault.

So the buyer would be on the hook for injuries or damages that are a result of her actions and the the seller would be on the hook for injuries or damages that are a result of his actions. Check out the sample land contract for an example of how this could be done.

In addition, the seller may require the buyer to maintain liability insurance to

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 “Just like property taxes and assessments, typically the buyer under a land contract is responsible for maintaining and paying for insurance throughout the duration of the contract.”  
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protect against claims for bodily injury, death, and personal property damage (e.g. wallets, computers, certain equipment, etc.). This will actually benefit the buyer, as she will be able to file a claim with the insurance company should any injuries or damage arise and will be able to recover the proceeds.

☞ What happens if the land is condemned or taken by the government?

While it may seem far-fetched, the government could decide at some point to condemn the land (i.e. deem that you cannot live on it or use it because of some sort of hazard or contamination). The government could also decide to acquire the land through its power of eminent domain to build a highway, for example. The parties should think through this scenario and determine what should happen. In both condemnation and eminent domain situations, the landowner is typically afforded some compensation from the government. Oftentimes, land contracts will state that the compensation in such scenarios goes toward the purchase price and anything remaining goes to the seller. This is not ideal for the buyer, because not only do they no longer get the land, they also lose out on all the prior installment payments. They basically get nothing. One way to address this inequity is to write the contract so that if there's any amount leftover, it goes to the buyer. See the sample land contract for an example.

☞ What happens if someone doesn't pay the bills on time?

Both parties may have obligations to keep up on certain bills related to the property, such as taxes and insurance premiums as well as utilities and other services. Often land contracts include a protection of interest clause which protects both parties should one party fail to make a payment. It says that the other party can make the payment and then be compensated. Let's say the buyer fails to make the property tax payment. The seller is still the legal owner and does not want to incur penalty fees in his name. So the seller is able to pay the bill and then require the buyer to reimburse him.

The same goes for any repairs on the property that the seller agrees to do. For example, if the seller never fixes the banister to the front door that she promised she would fix before the buyer signed the contract, then the buyer can pay the amount needed to fix the banister and deduct it from the total amount of the contract. How this is all handled should be set forth in the land contract.

☞ What if the buyer wants to assign or lease the land to someone else?

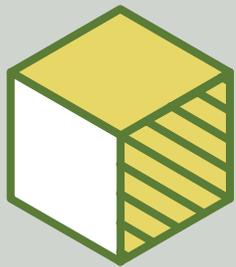
Just like a lease agreement, sellers often want to put restrictions on whether the

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 “The seller may also require the buyer to maintain liability insurance to protect against claims for bodily injury, death, and personal property damage.”  
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“Farmer-buyers should be wary of acceleration clauses, or at least be sure they negotiate a reasonable approach for letting them sublease the land to someone else if an emergency or need arises.”  
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buyer can lease or assign rights to the land to someone else. Every land contract should have a transferability provision which outlines any restrictions and processes that the buyer must follow if wanting to “transfer” her interest in the land. Oftentimes, this provision requires written permission by the seller. This makes sense since the seller still owns the land and she’ll likely want to have a say in who lives there to be sure they too will be good stewards. In addition, transferability provisions often have an acceleration clause. This means that if the buyer does not get written permission and leases the land to someone else, the seller can “accelerate” the contract by requiring that the buyer pay the full balance on the purchase price immediately or risk forfeiting her interest in the land.

This is a harsh consequence indeed. What if the farmer gets sick and needs to move to the city and needs to find someone to take care of the property? Farmer-buyers should be wary of acceleration clauses, or at least be sure they negotiate a reasonable approach for letting them sublease the land to someone else if an emergency or need arises.



# Sample Land Contract with Annotations

## Land Contract<sup>1</sup>

This LAND CONTRACT (“Contract”) is made between Penny Gordon (“Seller,” whether one or more) and Claire and Frank O’Conner (“Buyer,” whether one or more) as of December 31, 2015 (“Contract date”).

Seller and Buyer agree to the following terms:

### Land Description

The Seller warrants that she is the legal owner of real property in Coral County, Sun State, described as:

Common address: 1234 Zinnia Land, Zinc, Sun State, 55555

Legal Description: Lot 6,7, and the South ½ of Lot 3, West 60 feet of South ½ of Lot 4, West 60 feet of Lot 5 and Lot 8, Block 20, OLD SURVEY, Zinc, Coral County, Sun State.<sup>2</sup>

The above referenced real property is hereinafter referred to as “the Land.”



- 1 The land contract is also called a contract for deed, installment land contract, a long-term land contract, an installment sale contract, bond for deed, and a land sale contract. Check with your state to find the official term used.
- 2 The legal description of the property can be found on the deed, which is filed in the county recorders office.

### Purchase Price and Terms of Payment

Seller agrees to sell the Land and Buyer agrees to purchase the Land upon the Buyer paying Seller the sum of One Hundred Thousand Dollars (\$100,000) as follows:

- a. Down payment.** Buyer shall pay Ten Thousand Dollars (\$10,000)<sup>3</sup> at the execution of the Contract.
- b. Monthly Installments With Interest<sup>4</sup>:** The balance, together with interest on the whole sum at the rate of 2% per annum, shall be payable in 120 monthly installments.<sup>5</sup> The monthly installments in the amount of \$915.90 dollars per month shall begin on January 1, 2016 and be due and payable on the first day of each month through December 2025 or until the full balance is paid, whichever is sooner. Interest shall be computed monthly and each payment shall be credited first to any late charge due, second to interest, and the remainder to principal.

**Alternative 1:** Monthly Installments Without Interest<sup>6</sup>: The balance shall be payable in 120 monthly installments in the amount of \$ 750.00. The monthly installments shall begin on January 1, 2016 and be due and payable on the first day of each month through December 2025 or until the full balance is paid, whichever is sooner.<sup>7</sup>

**Alternative 2:** Balloon Payment<sup>8</sup>: The balance shall be payable, together with interest on the whole sum at the rate of 2% per annum in 60 monthly installments in the amount of \$500 dollars. The monthly installments shall begin on January 1, 2015 and be due and payable on the first day of each month through December 2019. The remaining principal and interest, in the sum of \$79,907.95 shall be paid in full on or before December 31, 2019. Interest shall be computed monthly and each payment shall be credited first to any late charge due, second to interest, and the remainder to principal.



- 3 While it may be a challenge to come up with the money, a significant down payment can be advantageous for the buyer if interest is involved. This is because it immediately reduces the principal owed, which is the basis for calculating how much interest accrues. In our example, for Frank and Claire, \$10,000 is a majority of their savings, but they are able to make the payment.
- 4 Under the monthly payment option with interest, the buyer will make even monthly payments throughout the term of the contract, here 10 years. However, because interest accrues on the unpaid principal, the down payment plus the monthly payments all added up together are significantly higher than the total purchase price. For example, here the purchase price is \$100,000 but based on the 2% per year interest, the total amount of monthly payments will be \$109,908. This is on top of the \$10,000 down payment. The difference of \$19,908 is the cost incurred for having the seller finance the land over time. This payment structure is comparable to a typical mortgage. Note that a higher down payment will lower the total amount paid over the course of the land contract, as the down payment directly reduces the principal on which the interest is calculated (see table below).
- 5 The installment payments don't have to be monthly. They could be made on whatever time frame makes most sense for the parties and the situation. For example, it may make more sense for a farmer to pay quarterly, semi-annual, or annual payments based on the cash flow of the farming season. It's up to the parties to negotiate.
- 6 Under the no interest monthly payment option, the buyer makes even monthly payments for the entire term of the loan. No interest is charged, and thus the down payment plus the monthly payments all added up will equate to the total purchase price, here \$100,000. The no interest monthly payment option is by far the most advantageous option for the buyer, but it is incredibly rare to find a seller willing to sell land on these terms.
- 7 The following table compares the monthly payments and the total amount paid over the term of the loan for payment options with and without interest. Each assumes a purchase price of \$100,000. Interest calculators are available online, which can help you determine how much you'll pay in each scenario—simply search “interest calculator.”

Loan Type	Down Payment	Loan Amount	Monthly Payment	Total paid on loan	Total paid on purchase price
Monthly-No Interest	\$10,000	\$90,000	\$750	\$90,000	\$100,000
Monthly-2% Interest	\$10,000	\$90,000	\$915.90	\$109,908	\$119,908
Monthly-2% Interest	\$20,000	\$80,000	\$814.13	\$97,696	\$117,696

- 8 Under the balloon payment option, the buyer makes even monthly payments similar to the first two options. However, at the end of a set time period—here five years, but it could be more or less—the buyer will be required to make a “balloon payment” or lump sum payment to the seller for the total amount due. The buyer will need to fund the balloon payment when it is due or will be deemed in default. If this is the case, depending on the state, the seller could declare that the buyer is in forfeiture of the land contract and the buyer could risk losing all prior payments. Farmers entering land contracts with a hefty balloon payment should be cautious. Read the Land Contract Overview to learn more about risks and options when going down the balloon payment route.

### Method of Payment

Unless otherwise provided in writing by Seller, all payments shall be delivered to Seller at 1830 N. Tulip Ave, Sunny, Ca, 55555. All payments shall be made in the form cash or check and be hand delivered or postmarked on or before the date the payment is due.<sup>9</sup>

### Prepayment

- a. No penalty.** Buyer retains the right to fully or partially prepay the balance owed on the Contract at any time without penalty.<sup>10</sup>

**Alternative 1:** Buyer retains the right to fully or partially prepay the Contract at any time after [December 31, 2017].<sup>11</sup>

**Alternative 2:** No prepayments are allowed under the Contract without written permission from the Seller.<sup>12</sup>

- b. Effect of Partial prepayment.** Any partial prepayment will apply first to the amount then due, including unpaid accrued interest, and the balance shall then be applied to the principal portion of future monthly installments in the inverse order of their maturity.<sup>13</sup> Partial prepayment shall not postpone the due date or amount of the installments to be paid pursuant to the Contract until the balance is paid in full.



- 9 This is a very key provision, as it specifies when the payments are due and how they must be made. Here, they must be postmarked on or before the first of each month. The more thorough these details are set forth in the land contract the better, as the parties won't be in doubt or dispute how payments are in fact made.
- 10 Whether the buyer can prepay all or a portion of the purchase price before it's actually due is an important consideration. Read the Checklist section of this guide to learn more about how to determine if prepayment should be allowed and what the consequences and benefits to both parties might be.
- 11 This can be an option to negotiate if the seller is concerned about tax consequences of an unanticipated large prepayment. By allowing prepayment only after a certain date, a full prepayment will be a lesser amount and will most likely not substantially increase the seller's tax basis.
- 12 Farmers should be wary of sellers that prohibit prepayment. Again, read your land contract carefully and try to negotiate with your seller to allow prepayment, at least under certain conditions (such as alternative 1).
- 13 Applying prepayments to the monthly installments in inverse order of maturity—i.e. payments from year 10 to year one versus payments from year one to year 10— means that the prepayment will not change any upcoming payments for the buyer. It's not as though you make a large prepayment and then don't have to pay for a few years. Instead, you have to keep paying the monthly installments, but the large prepayment will allow you to be paid in full and own title to the land at an earlier date.

### Evidence of Title

Seller warrants that the title to the Land is only subject to the following:

- a. Applicable laws, ordinances, and regulations;
- b. the lien of real estate taxes and instruments of special assessments which are payable by Buyer pursuant to paragraph 7 (Real Estate Taxes and Assessments) of the Contract;
- c. covenants, conditions, restrictions, or declarations of record;
- d. reservation of mineral rights by the State; and
- e. easements listed on the deed or recorded with the county.<sup>14</sup>

## Recording of Contract

Buyer shall, at Buyer's expense, record the Contract in the Coral County Recorder's Office within Four (4) months after the Contract date.<sup>15</sup> Buyer shall pay any penalty imposed under applicable state laws or regulations for failure to record the Contract.

## Possession and Use

Buyer shall have the right to possession of the Land from and after the Contract date and be entitled to retain possession so long as there is no default on Buyer's part in carrying out the terms and conditions of the Contract.<sup>16</sup> Buyer agrees to: (a) use, maintain and occupy the Land in accordance with any and all applicable building and use restrictions; (b) keep the Land in accordance with all police, sanitary, or other regulations imposed by any governmental authority, and (c) keep and maintain the Land and the buildings in as good condition as they are at the Contract date and not to commit waste, remove or demolish any improvements thereon, or otherwise diminish the value of Seller's security in the land—without the written consent of Seller.<sup>17</sup>



14 The seller must disclose all interests in the title in the land contract. This is a very important provision to review carefully. It will tell you if the land is subject to any mortgages, or rights of way, or easements. Basically, does anyone else have another rights or interest in land that might override the buyer's ownership interest? Even outside the land contract, the buyer should conduct due diligence—or research extensively—the status of the land. One way to do this is to look at the deed itself, which will list certain interests. You can also go down to the county's recording office to look through all the public records that are connected to the land. It sounds like a lot of work, but it's well worth it to rest assured that you will own the land outright without anyone saying otherwise.

15 The recording office is a governmental office that maintains public records and documents related to real property (land) ownership. The office stores public records including deeds, mortgages, liens, releases, leases, and other documents connected to land. Anytime there is an update to any of these documents, they need to be recorded so that the government and potential buyers can maintain a clear picture of who owns the land and who has various rights or interests in using the land. By recording the land contract at the county recorders office, the buyer is letting everyone know that she is buying the land. She will then be first in line so to speak to anyone who subsequently records an interest in the land. Let's say that the seller enters a land contract with another buyer two years down the road behind the back of the initial buyer. In some states, if the second buyer records the agreement first, then the initial buyer is out of luck. So be sure to record!

- 16 Right to possession is legal speak for just that—the right to possess or physically access the land. Right to possession is different than ownership, which for the most part comes with the right to do whatever the owner wants within the confines of the law. In a land contract, the seller retains ownership until the buyer makes the final installment payment or pays the full purchase price. However, the buyer has the right to possess the land throughout the duration of the contract. Think of it like a tenancy situation during the phase of the contract when the buyer is making the installment payments—the buyer is more like a tenant. Once the final payment is made, the seller transfers title to the land and then the buyer is officially the owner.
- 17 Along with the right to possession comes certain obligations that the buyer must abide by. Possessing the land is like borrowing it for the time being. If the buyer fails to make a payment or otherwise breaches the land contract, the seller will ultimately remain the owner of the land. These obligations are the legal standard for ensuring that the person that has the right to possess the land takes care of it as if it were her own—or leaves it in as good or better condition that she found it. This protects the seller should the land remain his.

### Delivery of Deed and Deed Tax

Upon full performance of the Contract, Seller shall execute, acknowledge, and deliver to Buyer a General Warranty deed<sup>18</sup> in fee simple<sup>19</sup>, in recordable form, conveying to Buyer marketable title to the Land, free and clear of all liens and encumbrances, except those created by the act or default of the Buyer or acknowledged within the Contract. Upon transferring title to Buyer, Seller shall pay the deed tax.<sup>20</sup>

### Real Estate Taxes and Assessments

- a. **Seller's warranty.** Seller warrants that all real estate taxes and assessments which were due and payable before the Contract date are paid in full.
- b. **Buyer's obligations.** Buyer shall pay all real estate taxes and assessments for the Land that are due and payable after the Contract date. Such payments shall be made before any penalties for non-payment are incurred. Buyer shall submit receipts to Seller upon request, as evidence of payment.<sup>21</sup>



- 18 In a general warranty deed, the seller promises that he has legal right to convey the land, that the property is free of liens or encumbrances (other than explicitly listed in the land contract), that the title is not defective, and that he will deliver any document necessary to make the title good. These are all important legal claims that protect the buyer should something go wrong. Note that a farmer purchasing land should be sure to only purchase land that comes with a general warranty deed. There are two other types of deeds—a special warranty and quitclaim deed—both of which can go for a lot less money. With a quitclaim deed, no promise whatsoever

is made—not even that the seller has the right to sell the land. With a special warranty deed, the seller only promises that he has not had problems with the title while owning the property—the state of the title that he purchased is not guaranteed. While tempting given the lesser purchase price, farmers should be very cautious of purchasing land under a quitclaim or special warranty deed, as they provide a lot less protection. For example, with both a special warranty and a quitclaim deed, the buyer will most likely not be able to mortgage the property in the future because the banks won't trust the deed. Even if you don't intend to mortgage the property yourself, this limitation will make selling the property more difficult down the road. Additionally, the buyer may have difficulty obtaining property insurance for the land. Insurance providers may not want to take the risk that someone else will show up with proper title to the land. It may seem strange and somewhat out of the pioneer days, but these things still do happen!

- 19 Fee simple is a legal term that means absolute title to the land, meaning the owner gets indefinite rights to land. The owner has the right to use the land to the full extent of the law, exclusively possess the land, and the land remains with the owner until he or she sells or transfers it by deed or will.
- 20 The deed tax—also known as the transfer tax—is a tax required by the county when property is transferred. It is generally paid by the seller.
- 21 Typically, in land contracts, the buyer must pay the property taxes and assessments on the land. However, this term can certainly be negotiated between the parties. Either way, the land contract should specify who is responsible for covering this obligation, as it can cause serious issues in the form of monetary penalties by the county if both parties assume the other is responsible and neither party pays. This is one condition that differentiates a land contract from a rent-to-own scenario. Typically, tenants do not pay property taxes while buyers under a land contract do. But again, these terms can be negotiated between the parties.

### Damage to Property and Property Insurance

- a. **Property insurance.** Buyer shall keep the Land and all buildings, improvements, and fixtures insured against loss by fire, lightning, and other hazards covered by standard extended insurance coverage, including but not limited to: vandalism, malicious mischief, burglary, and theft. Such insurance shall be in amounts reasonably satisfactory to Seller, which at a minimum is an amount equal to the full replacement value of the buildings, improvements, and fixtures on the Land without deduction for physical depreciation.<sup>22</sup>

- b. Loss Payable Clause.** The insurance policy shall contain a loss payable clause in favor of the Seller. Such clause shall provide that the Seller's right to recover under the insurance shall not be impaired by any acts or omissions of Seller or Buyer, and that Seller shall otherwise be afforded all rights and privileges customarily provided to a mortgagee under a standard property insurance policy.<sup>23</sup>
- c. Notice of Damage.** In the event of damage to the Land, Buyer shall promptly give evidence and notice of damage to the insurance company and Seller.<sup>24</sup>
- d. Application of Insurance Proceeds.** If the Land is damaged by fire or other casualty, the insurance proceeds paid on account of such damage shall be applied to the amounts payable under the Contract, even if such amounts are not then due, unless Buyer elects to conduct Repairs as specified in the next paragraph. Insurance proceeds applied to the amounts payable under the Contract shall be applied pursuant to Section 3(b)–Prepayment. The balance of insurance proceeds, if any, shall be the property of Buyer.<sup>25</sup>
- e. Buyer's Election to Conduct Repairs.** If Buyer is not in default under the Contract, or after curing any such default, Buyer may elect to have the amount of insurance proceeds necessary to repair, replace, or restore the damaged Land (the "Repairs") deposited in escrow with a bank or title insurance company qualified to do business in the State of Sun State or any other party mutually agreeable to Seller and Buyer.<sup>26</sup>
- i. Terms of escrow account.** Buyer's election to place insurance proceeds in escrow to conduct Repairs must be made to the Seller in writing within sixty (60) days after the damage occurs. Placing the insurance proceeds in escrow will only be permitted if Seller approves Buyer's plans, specifications, and contracts for the Repairs; Seller shall not unreasonably withhold or delay approval. If such funds are insufficient, Buyer shall, before the commencement of the Repairs, deposit into escrow additional funds necessary to cover the full cost of the Repairs as well as any escrow account fees and costs. If such funds exceed the full cost of Repairs and escrow account fees and costs, the escrow account shall be closed and any remaining funds shall be applied to the amounts payable under the Contract. Such amounts shall be applied pursuant to paragraph 3 (prepayment) of the Contract. The balance of insurance proceeds, if any, shall be the property of Buyer. All escrowed funds shall be disbursed in accordance with generally accepted sound construction disbursement procedures.<sup>27</sup>
- ii. Terms of Repairs.** Buyer shall complete the Repairs as soon as reasonably possible. Repairs should be completed in a good workmanlike manner in accordance with best practices in the industry. All Repairs shall be completed by Buyer within one (1) year after the damage occurs, unless Buyer and Seller otherwise agree in writing, or if completion within one year is commercially infeasible.<sup>28</sup>



- 22 Just like property taxes and assessments, typically the buyer under a land contract is responsible for maintaining and paying for property insurance throughout the duration of the contract. This provision specifies the minimum requirements of the property insurance policy in terms of amount and types of coverage, which can all be negotiated. The parties should strive to strike the right balance for the particular piece of land and circumstance. Depending on the situation, other items to specify insurance coverage include:
- Flood coverage. If any of the buildings, improvements, or fixtures are located in a federally designated flood prone area, and if flood insurance is available for that area, the seller may require the buyer to maintain flood insurance.
  - Earthquake Coverage. If any of the buildings, improvements, or fixtures are located in a seismic design category C, D or E according to FEMA, and if earthquake insurance is available for that area, the seller may require the buyer to maintain earthquake insurance.
- 23 This clause protects the seller’s interest in the land and her ability to recover on the insurance policy should damage to the land occur. Remember, the seller still owns title to the land until the buyer makes the final installment payment or pays the purchase price in full. However, the insurance policy is in the name of the buyer. This clause may be better understood through an example. Let’s say a fire burns three acres of Claire and Frank’s apple orchard at year three of the land contract. At this point, the loss payable clause will kick in to determine how the insurance process and proceeds are handled between the seller and the buyer. Basically, the seller—here Penny—will be afforded the same rights as an institutional bank in a mortgage situation. So, for example, if the buyer—here the O’Connors— fail to inform the insurance company that the damage occurred, Penny could step in and take care of it to protect her interest. The following provisions include more specifics on how this all would play out. This is just one example of how insurance could be handled in a land contract. It’s really up to the parties to determine what is best for their specific situation.
- 24 This “notice” provision makes sure that the buyer is in close communication with both the insurance company and the seller if and when damage to the land occurs and an insurance claim is filed. The buyer must notify the insurance agency to receive insurance proceeds on a claim, as it’s required by the policy. In addition, given the seller still technically owns the land, she’ll likely want to know what’s happening and do what she can to protect her interest in the land should the land contract ultimately fall through.
- 25 The provision ensures that the insurance proceeds related to property damage actually go back to the land. Either the funds are applied to the purchase price or, the buyer can choose to apply the funds toward the costs for repairing the damage so long as the seller approves how

the funds are spent. Using our example, let's say that Claire and Frank receive \$6,000 from the insurance company to cover the cost of the fire damage to the 3 acres of apple orchard. If Claire and Frank opt not to repair the damage, the \$6,000 in insurance proceeds will go to cover the purchase price. The proceeds will be applied to the last installment payments first, which means that Claire and Frank still have to pay the monthly installments on schedule. However, they will be paid in full and receive title to the land sooner as the \$6,000 is applied to the backend. Also, if Claire and Frank only have \$5000 left to pay off on the purchase price, they will get to pocket the remaining \$1000.

- 26 If Claire and Frank opt to replant the orchard and conduct repairs from the fire, the \$6,000 in insurance proceeds must be placed in a shared escrow account. This protects Penny, the seller, by giving her visibility and some level of control to prevent the funds from being swindled away. Keeping it in an escrow account ensures that Penny has full transparency to see what is happening to the money and that it is in fact being used to replant apple trees, repair the irrigation system, rebuild fences, and so forth.
- 27 This provision explains how the escrow account must be managed. As it is written, the buyer has to get the seller's approval on all the plans for repair before making the repairs. This way the seller has a say in the quality of the work and can provide input into what is actually done; after all, it is the seller's land until the purchase price is paid in full. For example, Claire and Frank can't use the money to build a pond if Penny insists that the damaged area remain an orchard. This provision also specifies who's responsible if the insurance proceeds do not cover the full cost of the repairs, or conversely, if they exceed the cost of the repairs. Here, the buyer is responsible for covering the difference if the insurance proceeds are short. If they are in excess, the difference is applied to the purchase price. These are all essential points of consideration for the parties to negotiate should this scenario arise: Is insurance required? Who pays for insurance? What happens if the land is damaged? Who pays for any costs that aren't covered by insurance? Who gets to decide whether and how repairs are made? The way all these issues are handled in this land contract is just one example. It's up to the parties to negotiate what's best in their situation.
- 28 This provision specifies the terms of how the repairs will be conducted. It requires that any repairs are done in a professional manner, in accordance with best practices. This ensures that the buyer won't make band aid fixes and then run off as the situation implodes in the hands of the seller given the seller officially owns the land.

## Injury or Damage Occurring on the Land and Liability Insurance

- a. **Liability Insurance.** Buyer shall, at Buyer’s own expense, procure and maintain liability insurance against claims for bodily injury, death, and personal property damage occurring on or about the Land in amounts reasonably satisfactory to Seller and naming Seller as an additional insured.<sup>29</sup>
- b. **Seller’s Liability.** Seller shall be free from liability and claims for damages by reason of injuries occurring to any persons or property while on or about the Land after the Contract date. Buyer shall defend and indemnify Seller from all liability, loss, cost, and obligations, including reasonable attorneys’ fees, on account of or arising out of any such injuries.<sup>30</sup>
- c. **Buyer’s Liability.** Buyer shall have no liability obligation to Seller for such injuries which are caused by the negligence or intentional wrongful acts or omissions of the Seller.<sup>31</sup> Seller shall defend and indemnify Buyer from all liability, loss, cost, and obligations, including reasonable attorneys’ fees, on account of or arising out of any such injuries.



- 29 Liability insurance is different than property insurance; it covers injuries to people and damage or loss of personal property such as wallets, tools, and certain equipment. Land contracts typically require the buyer to maintain sufficient liability insurance should such a situation arise. However, these terms can be negotiated between the parties.
- 30 This provision means that after the contract date, the seller is not on the hook for injuries that occur on the property to third parties— such as a visitor or employee, or the health insurance company of a visitor or employee. This provision also includes an indemnification clause, which is simply a promise by another party to cover your losses if he or she does something that causes you harm or causes a third party to sue you. Indemnification provisions can vary quite a bit. Here, this indemnification provision means that if someone sues the seller for an injury that occurred on the property after the contract date, the buyer has to step in and help defend the lawsuit and pay for any costs or damages as a result—unless the injury is somehow tied to the fault of the seller, which the next provision addresses.
- 31 Similar to the previous provision, this provision means that the seller acknowledges that the buyer is not on the hook for any damages or costs associated with an injury of a third party that is somehow linked to the fault of the seller. This provision also includes an indemnification clause. This time, if someone sues the buyer for some injury that occurred on the property that was caused by the negligence or wrongful act of the seller, the seller must cover the costs. Basically, each party pays for the faults of their own actions.

## Insurance Generally

The insurance which Buyer is required to procure and maintain pursuant to Sections 9 and 10 of the Contract shall be issued by an insurance company or companies licensed to do business in the State of Sun State and acceptable to the Seller. The insurance shall be maintained by the Buyer at all times throughout the duration of the Contract. Buyer shall deliver to Seller a duplicate original or certificate of such insurance policy or policies. The insurance policies shall provide for at least ten (10) days written notice to Seller before cancellation, non-renewal, termination, or change in coverage. Buyer shall pay the insurance premiums when due and submit receipts to Seller upon request, as evidence of payment.<sup>32</sup>

## Improvements

Buyer may make improvements to the property only upon the prior written consent of the seller. The seller may require additional approval of specific designs and construction terms before any improvements are made. The term “improvements” as used herein means building or installing permanent structures, fixtures, or other elements of infrastructure on the land that cannot be removed without causing permanent damage to the Land. Unless otherwise agreed to in writing by the parties, buyer shall incur the full cost of improvements. If buyer removes any structure or item that buyer builds or installs that is not considered an “improvement”, buyer is responsible for repairing any and all damages incurred in its removal.<sup>33</sup>



32 This simply reiterates that the buyer must maintain insurance by a legitimate insurance provider, and must stay up-to-date on the payments.

33 This clause sets forth the arrangement for making improvements or permanent changes to the land. Often farmers want to make substantial improvements to the land right away. However, with a land contract, they need to be careful as they don't actually own the land until the last payment is made and therefore risk losing everything. This clause defines improvements in a way that allows the farmer to take anything so long as it does not cause permanent damage to the land. Any improvements require prior written consent of the seller. This protects the seller's interest; after all, she still owns the land. So, if the farmer decides to build a moveable greenhouse or grow tunnel, then that's fair game. However, if the farmer builds something more elaborate that is attached in a way that would damage the land upon removal, then that will stay with the land and the farmer would lose all the costs incurred in making the improvement. This is definitely one of the drawbacks of a land contract. The parties can certainly try to negotiate an arrangement where they split the difference or come up with another way to allocate the costs. Here, this would be on a case-by-case basis, as unless otherwise agreed in writing, the farmer bears the cost of the improvements.

## Waste, Repair, and Liens

Buyer shall neither commit any affirmative or permissive waste<sup>34</sup> or allow waste to be committed on the Land, nor remove or demolish any buildings, improvements, or fixtures now located on or a part of the Land, nor remove or demolish any improvements later located on or a part of the Land, nor create or permit to accrue liens or adverse claims against the Land which constitute a lien or claim against the Seller's interest in the Land without the written consent of Seller.<sup>35</sup> Buyer shall keep the Land in good tenantable condition and repair. Buyer shall pay to the Seller all amounts, costs and expenses, including reasonable attorneys' fees, incurred by the Seller to remove any such liens or adverse claims.

## Condemnation

If all or any part of the Land is taken in condemnation proceedings instituted under the power of eminent domain or is conveyed in lieu thereof under threat of condemnation, the money paid pursuant to such condemnation or conveyance shall be applied to the amounts payable by the Buyer under the Contract, even if such amounts are not then due. Such amounts shall be applied pursuant to paragraph 3 (prepayment) of the Contract.<sup>36</sup>

- a. **Condemnation or Conveyance of Entire Land.** If the Land in its entirety is condemned and the payment amount does not fully cover the remaining payments owed to the Seller, the Contract shall terminate, and the Buyer shall owe no future payments, after the date of condemnation. If the entire property is condemned and the payment amount fully covers the remaining payments owed to the Seller, any balance shall be the property of the Buyer.
- b. **Partial Condemnation or Conveyance.** If part of the Land is condemned, such condemnation payments shall not postpone the due date of the installments to be paid pursuant to the Contract or change the amount of such installments. Any balance shall be the property of the Buyer.



<sup>34</sup> Waste refers to harm to the property. Affirmative waste refers to willful destruction of the property that lowers its value, including depleting natural resources available on the property. Basically, Frank and Claire cannot mine all the coal on the land, burn down an orchard, or destroy a house on the land. Permissive waste refers to negligence or neglect that allows the land to fall into disrepair. Negligence is the failure to do or not to do something that a reasonable person would do in similar circumstances. For example, a reasonable person would perform ordinary repairs and maintenance to the irrigation system. If Claire and Frank fail to do so and the irrigation system breaks, they have breached this provision of the contract because they have committed permissive waste. If they deliberately burn down the orchard, they have breached this provision by committing affirmative waste. Provisions prohibiting the person who is in possession of land to commit affirmative and permissive waste are standard in all land contracts as well as leases.

- 35 This means that the buyer cannot encumber or give legal rights to anyone else in the land without the prior consent of the seller. This could include granting someone an easement or right away or taking out an equipment loan using the property as security. Note that some states allow the buyer to obtain a mortgage on a land contract, for example to pay a balloon payment. If your state allows for it, the contract may stipulate that the buyer may obtain a mortgage on the land. It will also need to specify whether the bank or the seller will be the senior creditor in such a situation. Oftentimes, institutional lenders will insist on being first in line, yet the seller will likely not agree to being a junior creditor. This is best explained with an example. Let's say that Claire and Frank decide to mortgage the property to help with their monthly installment payments. However, in many states, the land contract is treated as a mortgage. If this is the case, the seller, here Penny, would be considered first in line as in effect she is financing the purchase price through the land contract. So either Penny would have to agree to be second in line or the institutional bank would have to agree to take a second lien on the property and be second in line to Penny. This illustrates how challenging it can be to take out a mortgage on a property subject to a land contract!
- 36 This provision kicks in if the government comes in and condemns the land for whatever reason or decides to use eminent domain rights to purchase the land to, for example, build a highway. This is another important consideration, as imagine if this were to happen at some point through the course of the land contract, who gets what or who loses what? It's important to lay out the terms clearly at the outset. The way it's written here is just one example to fairly strike the potential risk of loss between the parties.

### Compliance with Laws

Except for matters which Seller has created, suffered, or permitted to exist prior to the date of the Contract, Buyer shall comply with all laws ordinances and regulations of any governmental authority which affect the Land or the manner of using or operating it, and with all restrictive covenants, if any, affecting title to the Land or the use thereof.

### Protection of Interest

If Buyer fails to pay any sum of money or fails to perform any obligation required under the Contract, Seller may pay the cost of such performance, and the cost shall be payable at once by the Buyer to the Seller, with interest at rate stated in Section 2 (Purchase Price) of the Contract, as an additional amount due under the Contract. If Seller fails to pay any sum of money or fails to perform any obligation required under the Contract, Buyer may pay the cost of such performance, and if the Buyer is not in default of the Contract, the cost shall be deducted from future installments or payments, with interest at rate stated in

Section 2, in inverse order of maturity. Neither shall postpone the due date of the installments to be paid pursuant to the Contract or change the amounts of such installments.<sup>37</sup>

### Defaults and Remedies<sup>38</sup>

- a. **Time is of the essence:** The time of performance by Buyer of the terms of the Contract is an essential term of this Contract.<sup>39</sup>
- b. **The parties stipulate that the Contract shall be treated as a mortgage under the laws of Sun State.**<sup>40</sup> Seller and Buyer agree that in the event of a default in the payment of principal or interest or default in performance of any other obligation of Buyer which continues for a period of thirty (30) days,<sup>41</sup> Seller may only seek recourse through state mortgage and foreclosure laws. Seller hereby forfeits the right to strict foreclosure.

**Alternative 1:**<sup>42</sup> Buyer agrees that in the event of a default in the payment of principal or interest which continues for a period of forty-five (45) days following the due date or a default in performance of any other obligation of Buyer which continues for a period of 120<sup>43</sup> days following written notice thereof by Seller (delivered personally or mailed by certified mail), the entire outstanding balance under the Contract shall become immediately due and payable.<sup>44</sup> Following any default in payment, interest shall accrue at the rate of Five (5) per cent annum on the entire amount in default.

**Alternative 2:**<sup>45</sup> Seller may elect to declare the Contract cancelled and terminated by notice to Buyer. If Seller elects to terminate the Contract, all right, title, and interest acquired under the Contract by Buyer shall then cease and terminate, and all improvements made upon the Land and payments made by Buyer pursuant to the Contract (including escrow payments, if any) shall belong to the Seller as liquidated damages for breach of the Contract. Any extension of time for payment shall not be valid unless in writing and signed by the Seller and Buyer.<sup>46</sup> After service of notice of default and failure to cure such default Buyer shall surrender possession of the Land to Seller. Failure by the Seller to exercise one or more remedies<sup>47</sup> available under this paragraph shall not constitute a waiver of the right to exercise such remedy or remedies thereafter.<sup>48</sup>



37 This provision protects both parties should one or the other fail to make payments, such as taxes or insurance premiums or other obligations. If this happens, the other party can make the payment and effectively be reimbursed for it. This helps to prevent penalty fees from piling up. However, covering these payments does not alter when the installment payments are due.

38 While it's not titled as such, this is what's known as the forfeiture clause. It basically lays out what happens if the buyer fails to make an installment payment or balloon payment when due or otherwise fails to abide by the terms of the agreement such as maintaining insurance

or not properly maintaining the land. The buyer could then be deemed in “default,” and this “default and remedies” provision—i.e. forfeiture clause—will kick in. Forfeiture clauses in a land contract can be rather paradoxical. That’s because no matter what the parties agree to in the contract, a court may in fact apply a different set of rules based on fairness and equity. This is an area of very state specific law, which is far too detailed and nuanced for this guide to cover state by state. However, the Overview of Land Contracts section outlines some of the various ways courts deal with forfeiture clauses. Be sure to review that section if you want to more fully grasp the specific risks and processes involved should you happen to miss a payment or otherwise default on the land contract.

- 39 This “time of the essence” provision is a legal clause that reiterates the importance of making payments on or before the due date—not a day late!
- 40 Treating as mortgage: Forcing the seller to act through state foreclosure laws—essentially treating the land contract as a typical mortgage—affords the buyer the most protection. Many states are moving in the direction of treating land contracts as mortgages, regardless of what the contract says. But if your state allows the seller to use stricter remedies, putting this clause in your contract affords the buyer the utmost protection in the event of default. This is because it forces the seller to go through lengthy and costly foreclosure proceedings in order to maintain her rights in the land should a buyer be deemed in default. A lot of sellers would prefer not to go through this process, and may prefer to negotiate another strategy such as lengthening the grace period to be sure the contract does not ultimately fall through. Several states default to this option, including: Indiana, Kentucky Maryland, and Oklahoma. Additionally, courts in Ohio, Nebraska, New York, Florida, and California are moving in the direction of treating land contracts as mortgages.
- 41 This is a grace period, which typically will last between 30-90 days.
- 42 Equity of Redemption. This option grants the buyer slight protection. In the event that the buyer fails to make a late payment within the allotted grace period of 30 days, the buyer must pay the full balance of the contract, or face foreclosure. However, if buyer makes the late payment within the grace period, the land contract continues as if there was no problem. Note that while this option affords the buyer some protection, in the event of a breach, the buyer essentially must make a balloon payment—or a payment in full by the specified time. Several states will default to this provision, including: California, Florida, Hawaii, Missouri, Montana, South Dakota, Arizona, Iowa, Minnesota, North Dakota, Oregon, Texas, and Washington.
- 43 Generally, the second period covers any failures or breaches under the contract other than making the installment payments on time, such as failure to maintain real estate taxes, proper

upkeep, etc. The way this is written allows for a longer grace period given the breach is less serious and may take longer to fix. This longer grace period for non-payment related issues could be incorporated in the Treating as Mortgage option as well. It's up to the parties to negotiate what grace periods apply for what, these are just examples.

- 44 In the event that the breach is not cured within the stated number of days and the buyer fails to make the balloon payment, the seller will generally have a number of potential options depending on state law, including initiating strict foreclosure (which basically means the buyer loses all interest in the land, as well as all prior payments), filing a lawsuit for the unpaid purchase price, having the buyer ejected from the land, and so forth.
- 45 Blanket Forfeiture Clause. Farm Commons strongly advises farmers not to enter into a land contract with a provision similar to this option. This option only provided here as an example of a very seller-friendly provision that should be seen as a red flag to potential buyers. It allows the seller to immediately retake the land and keep all prior payments upon failure to make ANY payment or failure to perform ANY duty. This is a very harsh and unfair consequences, so be wary.
- 46 Of note, even if the seller tells the buyer in a conversation that it's okay to miss a month pay two months at once, unless such an arrangement is in writing, the seller can decide at any time NOT to allow this and instead declare that the buyer is in default. In other words, get it in writing. Even if it's not required in the contract, it is best practice to get an agreement for delayed payment in writing, as it helps provide evidence of your agreement should an issue arise.
- 47 Also of note, even if the seller as allowed the buyer to make late payments in the past, unless the arrangement is in writing, the seller is not required to continue to allow late payments in the future and can say it's a default. In other words, just because the seller is nice and forgiving once doesn't mean she'll always be.
- 48 Again, this is a very harsh forfeiture clause and farmers are advised to stay far away from land contracts with similar provisions. Needless to say, this provision is not legally enforceable in many states.

### **Binding Effect**

The terms of the Contract shall run with the land and bind the parties hereto and the successors in interest.<sup>49</sup>

### **Transferability**

Buyer may not transfer, assign, sell, or convey any legal or equitable interest in the property, including but not limited to a lease for a term greater than one year, without the prior written consent of Seller.

Should any such transfer, assignment, sale, or conveyance occur without Seller's written consent, the entire outstanding balance payable under the Contract shall become due immediately and payable in full at Seller's option.<sup>50</sup>

### Severability

If any one or more of the provisions contained in the Contract shall be held illegal or unenforceable by a court, no other provisions shall be affected by this holding. The parties intend that in the event one or more provisions of this agreement are declared invalid or unenforceable, the remaining provisions shall remain enforceable and this agreement shall be interpreted by a court in favor of survival of all remaining provisions.<sup>51</sup>

### Headings

Headings of the paragraphs of the Contract are for convenience only and do not define, limit, or construe the contents of such paragraphs.<sup>52</sup>

### Entire Agreement.

The Contract constitutes the entire understanding between the parties with respect to the transactions contemplated herein. All prior or contemporaneous agreements, understandings, or representations, oral or written, are merged into the Contract.<sup>53</sup>



49 This provision is typical for any agreement related to real estate. It means that this contract is tied to the land and not just the parties. In effect, if one of the parties dies, the heirs of that party who get the land will be bound by the contract. Or, if the seller defaults on a mortgage and a bank forecloses on the land, the bank would have to abide by the contract. In effect, the contract and all its rights and obligations comes with the land.

50 This clause addresses what would happen if Claire and Frank tried to lease or even sell their interest in the land to someone else without Penny's written permission. Let's say Frank gets sick and has to move to the city near a hospital and Claire and Frank find a young couple to live on the land and pay rent while Penny and Frank are gone. As this provision is written, Claire and Frank need to get Penny's permission before entering a lease. If they don't, and Penny finds out, she could require that the purchase price is paid in full immediately. This is legally known as acceleration. For more on transferability and acceleration clauses, consult the Checklist section of this guide.

51 This is a legal clause found in most contracts. It basically means what it says. If one provision is found by a court to be illegal or unenforceable, the rest of the agreement still stands.

- 52 This is another legal clause found in most contracts. It means that if and when a court interprets the contract, the headings aren't determinative of what the provisions themselves actually mean.
- 53 This means that this contract overrides any preliminary agreements or arrangements that the parties may have entered into or discussed before they signed this contract.

SPECIAL LEGAL ISSUE:

WHY ARE LAND CONTRACTS TREATED DIFFERENTLY?

## Land Contracts are Unique in the Eyes of the Law

Land contracts are different from other contracts as well other areas of law. The way they are treated varies from state to state. To understand why, it's helpful to dive into a bit of legal background, including the basics of common law and principles of equity. This section is not for the faint of heart! But for those of you that are intrigued, keep reading.

### Basics of common law

Common law—also known as case law or precedent—is developed by the courts, as opposed to statutes enacted by the legislature or regulations created by government agencies. If a statute or regulation applies to an issue in a case, the court must apply the statute or regulation as it overrides common law. However, if there are no statutes or regulations that apply to a distinct issue, courts turn to past decisions of cases with similar facts and circumstances. They then apply the prior case law or precedent to determine the outcome of the present case, making certain tweaks as needed to adapt to the distinct facts and circumstances of the present case. Indeed, no two cases before a court are exactly the same. This explains how common law morphs and evolves over time—as more and more cases are decided by the courts, more and more common law is created, refined, and even changed as social and cultural norms change. The court system in each state has its own common law that has developed over time, making common law—and the courts treatment of land contracts— vary quite a bit from state to state.

### Issues of law and issues of equity related to land contracts

Common law is made up of two systems—law and equity. Issues of law are handled by applying the law as it's written to the facts of the case—the law is precisely what the relevant statute, the regulation, or even what the terms of the disputing parties' contract say. So if a land contract has a forfeiture clause and the buyer defaults on the last installment of a 20-year contract, when deciding the issue of law, the court will say too bad, she loses everything because that's what it's written in the contract. In other words, when deciding issues of law, the court strictly enforces the law or the terms of a contract as written, with absolutely no exceptions.

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Issues of equity typically refer to a set of remedies or procedures to ensure a fair outcome in the case. When faced with issues of equity, courts basically weigh the injustices of applying the law and the associated legal remedy, so to speak. Given a rare set of circumstances, the court will override the remedy that the law demands and create what’s called equitable relief to be applied in all similar circumstances. In this way, the courts have devised equitable doctrines to alleviate high level of social or economic inequities that arise when the law is strictly applied in certain situations. In the case of the land contract, some courts have stepped in and crafted a form of relief for the buyer that is more fair or equitable than completely forfeiting the land upon default even if that’s what the land contract expressly says.

Basically, some courts have said, well, in all fairness, if a buyer has built equity in the land for nearly 20 years, she should at least have an opportunity to make the final payment or at least get back the equity she’s invested just as a mortgagor does if she defaults on her home loan payment. Here, allowing the buyer to have another chance to avoid the harshness of a forfeiture clause is what’s considered equitable relief.

Originally, courts of law and courts of equity were actually separate. However, in the federal courts and in most states they have merged and a single court can decide both issues of law and issues of equity.

### **Why land contracts are treated differently in different states**

The common law process of the court system and the distinction between issues of law and issues of equity explain why land contracts are treated differently state by state. Basically, state courts have struck a different balance in applying the strict law of forfeiture clauses and applying principles of equity or fairness when devising a remedy for when one party doesn’t hold up their end of the deal. Moreover, many state legislatures have also stepped into the mix because they have been unhappy with how their state courts have struck this balance. These state legislatures have enacted statutes to override the common law in their state on the issue of forfeiture clauses in land contracts. Again, common law of the court applies only when there’s no statute or regulation on point. Once a state legislature passes a statute governing the issue of forfeiture clauses in land contracts, the courts in that state have to disregard the common law precedent and strictly apply

what the statute says to do from then on. Needless to say, it can get confusing!

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“Keep in mind, it’s only on a very rare occasion that courts will step in and override the terms of a contract based on an equitable doctrine.”  
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**Why land contracts are different from other contracts and areas of law**

Land contracts are unique and different from other contracts and other areas of law precisely because of how the courts have applied the equitable conversion doctrine as well as how the state legislatures have enacted specific statutes to deal with forfeiture clauses. Keep in mind, it’s only on a very rare occasion that courts will step in and override the terms of a contract based on an equitable doctrine. Courts are typically not as paternalistic and will completely defer to the free will of the parties to come up with their own terms under freedom to contract principles, and will apply those terms as written when deciding the outcome of a contract dispute. Moreover, farmers may get confused and think that perhaps they could get away with not abiding by employment laws or food safety laws on some kind of equitable grounds. Farmers might be thinking, why not just go to court and pull at the judge’s heart strings by arguing it’s too harsh and simply not fair to have to comply with these laws? But this won’t work. Employment laws and regulations at both the state and federal level override common law as these consist of statutes and regulations enacted by the state and federal legislatures or government agencies. Common law only applies when no statute or regulation is on point. So there’s no easy out when it comes to abiding by such laws and regulations.

Do you have questions or thoughts on how to improve this document? We want to hear from you. Please email us!

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