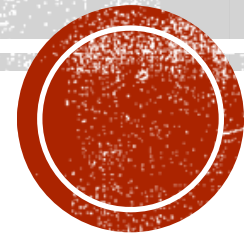


# LAND CONTRACTS

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# LAND CONTRACT:

## LONG-TERM EXECUTORY CONTRACT FOR THE SALE OF LAND

Other names:

Installment Land Contract,  
Contract for Deed, etc.



# RIGHTS & OBLIGATIONS

## Buyer

Regular Principal and Interest Payments

- Usually annual
- To the Seller

Takes possession of property at outset of contract

## Seller

Retains title until all payments made

May retain possessory interest in some of the property



# BENEFITS

## **Buyer**

Able to possess land without access to commercial credit  
No significant down payment

## **Seller**

Simple means of transferring farmland  
Ease tax consequences into installments  
Greater pool of potential buyers  
Can retain a life estate in the homestead



# RISKS

## Buyer

Forfeiting possession in default  
Forfeiting payments made in default

## Seller

Buyer default  
Decline in land values  
Waste  
Bankruptcy of Buyer



# DEFAULT & FORFEITURE

High risk of default, Buyer often ineligible for commercial or FSA lending

Nearly all land contracts protect the Seller with a **forfeiture clause**

If Buyer defaults on a payment they forfeit  
possession of property, **and**  
all payments made to date

Sometimes considered a form of liquidated damages

can become unreasonable, especially when buyer has:  
made most of the contract payments, or  
made significant improvements to the farm prior to default

Varies greatly by jurisdiction



# DEFAULT & FORFEITURE THEORIES BY JURISDICTION

**Enforce** forfeiture clause but require Seller provide brief **right to cure** and a **right of redemption** upon full payment of the contract (Maine)

**Restitution** theory requiring Seller to return any payments beyond Seller's actual damages

**Rental** theory of damages

**Fair market value** of land at time of default in relation to contract price (New Hampshire)

Restatement of Property §3.4(a) regards the land contract as a **mortgage**, and Seller's remedy is **foreclosure**. Foreclosure sale price determines duties, if in excess of the contract Buyer receives payment, if less than contract price, Seller has a right to the deficiency. (Fla., Ind.)





# MAINE

## Land Contract Statute 33 M.R.S. §481.2

### Detailed requirements for land contract provisions

- Statement that the contract is not a mortgage, and Buyer does not take title until fully paid 33 M.R.S. §481.2(K)
- Statement of rights of Buyer to cure default established in Title 14, §6111
- **However** 14 M.R.S. §6111.1 only provides a right to cure in “residential property located in the state when the mortgagor is occupying all or a portion of the property as the mortgagor’s primary residence and the mortgage secures a loan for a personal, family or household use...”
- 33 M.R.S. §6203-F foreclosure statute provides a right to cure, right of redemption and opportunity to extend the right of redemption up to 1 year. Also only applies to residential real estate.





# MAINE LAND CONTRACT CASE LAW

Thurston v. Galvin (2014)

- Purchaser's rights are limited to possessory rights until the final payment.
- Sale of property would impermissibly violate vendor's property rights

*“We recognize that a growing number of courts have held that a land installment contract should be treated as a mortgage... We note, however, that the contract... contains no language suggesting that Galvin should be permitted to recoup any of the payments made before breaching the contract. In addition, our treatment of a land installment contract as a mortgage would render meaningless the words ‘the rights of the purchaser in the contract’ in section 6203-F. This we cannot do.”* Thurston at 21.



# VERMONT

Strengowski v. Gomes (1970)

- Sole VT Land Contract case
- Breach of a land contract does not create landlord/tenant relationship
- Buyer not subject to summary ejectment procedures under landlord tenant law
- *“Contracts of this character, contemplating the purchaser’s use and occupancy of the premises, are regarded in equity as analogous to equitable mortgages. The right of forfeiture or defeasance for a breach of the covenants contained in the contract was only in aid of the security.” Strengowski at 750*



# NEW HAMPSHIRE

Newcomb v. Ray (1955)

Court ordered restitution to a defaulting buyer under a land contract.

*“[T]he part payments made by the plaintiffs represent a net benefit to the defendants... when added to the net amount actually received by the defendants from the sale of the property, they exceed the net amount which the defendants would have received from the property if the plaintiffs had completed the purchase of it... The plaintiffs are entitled to that part of \$1,700 which is ‘in excess of the harm’ caused to the defendants by the plaintiffs’ breach of the contract.”*



# NEW HAMPSHIRE CONT.

Randall v. Riel (1983)

Forfeiture case remanded

*“[R]easonable damages should be determined as the difference between the market value of the property and the contract price, plus such other special damages as may have resulted from the plaintiff’s breach of the contract for deed.”*

Citing Bower v. Davis & Symonds Lumber Co. (1979)

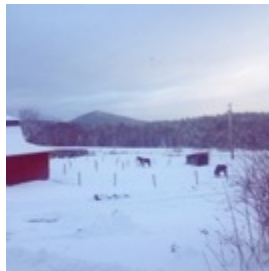
*“\$10,000 liquidated damages provision was reasonable because property was sold in an arms-length transaction after breach for \$90,000 which was less than the \$100,000 contract price.”*



# MASSACHUSETTS

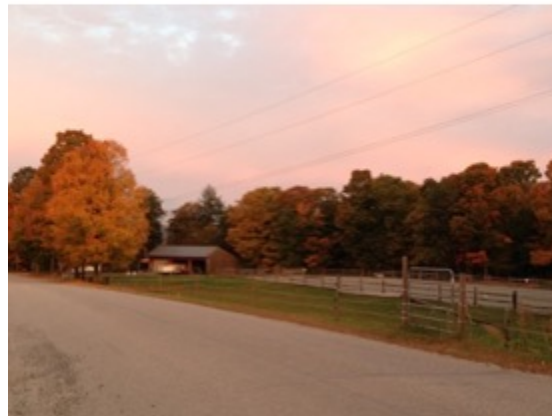
Cameron v. Gunstock Acres, Inc. (1976)

*“A purchaser under an instalment land contract resembles a mortgagor in some respects. Barrell v. Britton (1923). But the plaintiff does not tell us what right he claims under the law of New Hampshire, which would seem to control any mortgage analogy. Cf. Churchill v. Bigelow (1955).”*



# RHODE ISLAND

No case law or statutory provisions on land contracts.



# CONNECTICUT

La Fleur v. Pohronezny (2009)

Superior Court of Connecticut upheld forfeiture provision in a bond for deed, treating it as a valid liquidated damages clause.

*“Connecticut recognizes the right of parties to agree to liquidated damages in the form of a forfeiture of a deposit or a portion thereof for breach of an agreement to purchase real estate.”*

*The court enumerated criteria for enforceable liquidated damages clauses:*

*(1) Damages uncertain in amount or difficult to prove*

*(2) Intent of parties to liquidate damages in advance; and*

*(3) Amount stipulated was reasonable. Not greatly disproportionate to amount predicted by parties contemplating a breach of the contract.*

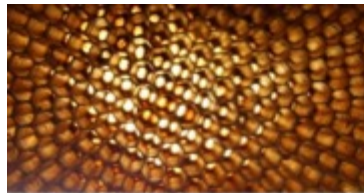
*Burden of proof on breaching party to show damages “so exorbitant as to be in the nature of a penalty.” Pohronezny citing Syncsort Inc. v. Indata Services (1988)*





# FSA LAND CONTRACT GUARANTEE PROGRAM

- New in the 2014 Farm Bill
- Could mitigate risks to sellers
- Unclear how buyers in default would fare
- Two types of guarantees: Prompt Payment and Standard



# FSA LAND CONTRACT DEFINITION

“An installment contract executed between a buyer and a seller for the sale of real property, in which complete fee title ownership of the property is not transferred until all payments under the contract have been made.”

7 C.F.R. §761.2(b)



# FSA LAND CONTRACT GUARANTEES

1. **Prompt payment guarantee** will guarantee payment of an amount not to exceed three amortized annual payments, plus real estate taxes and insurance for the period covered by the annual installment.
2. The **standard guarantee program** will guarantee an amount equal to 90% of the outstanding principal under the land contract. Outstanding principal is calculated as the outstanding balance less the liquidated or appraised value of the real estate.



# ELIGIBILITY

1. Buyer must be a

- Beginning Farmer (BF)
- Socially disadvantaged farmer or rancher (SDFR)

7 C.F.R. §763.5(b)(1)



# DEFINITION OF BEGINNING FARMER

- No more than 10 years operating a farm
- For entities, all members must meet this definition
- BF participates in operation “materially and substantially”
- Must not already own farmland or owns a farm sized 30% or less than the average farm acreage in that county
- Demonstrate resources of both BF and spouse insufficient to enable BF to enter or continue farming on a viable scale

7 C.F.R. §761.2(b)



# **DEFINITION OF SOCIALLY DISADVANTAGED FARMER OR RANCHER (SDFR)**

- Member of a group subjected to racial, ethnic or gender prejudice
- FSA enumerates a complete list of these groups:  
American Indians or Alaskan Natives, Asians, Black or African Americans, Native Hawaiians or other Pacific Islanders, Hispanics, and women.
- For entities, the majority interest must be held by SDFR individuals.
- For married couples, SDFR individual must have 50% ownership interest, make most of the management decisions, contribute significant labor, be generally recognized as the operator of the farm.

7 C.F.R. §761.2(b)



# ELIGIBILITY, CONT.

2. Buyer owner & operator of a “family farm” after contract completed 7 C.F.R. §763.5(b)(2)  
Family farm defined by 7 C.F.R. §761.2(b), not just a rural residence.
3. Farming experience  
Buyer must have participated in business operations of farm at least 3 of last 10 years  
Can count 1 year postsecondary agriculture education 7 C.F.R. §763.5(b)(3)
4. Citizenship Status  
Citizens of U.S. or lawful permanent resident 8 U.S.C §1641 and 7 C.F.R. §763.5(b)(7)
5. Credit History  
Acceptable credit history demonstrating satisfactory debt repayment.  
Unacceptable: History of failure to pay  
Acceptable: isolated incidents of late payments or lack of credit history





# LIMITATIONS

The purchase price of the farm may not exceed the lesser of \$500,000 or the current fair market value of the property. Existing land contracts are not eligible for the program. A guarantee may not be used to establish or support non-eligible enterprises.

7 C.F.R. §763.6



# FEASIBILITY

The buyers proposed operation must be feasible. Projected income, expenses and production estimates must be based on the buyer's last three production cycles. For those farming less than 3 years, a combination of actual history and other reliable sources may be used. When a feasible plan depends on income from sources other than farming, the income must be dependable and likely to continue.

7 C.F.R. §763.10



# CONTRACT TERMS & MODIFICATIONS

- Minimum 5% down payment
- Fixed interest no greater than Agency's direct farm ownership loan rate at approval time plus 3%
- Loan amortized for at least 20 years with equal annual installments
- Balloon payments prohibited during the 10 year terms of the guarantee

7 C.F.R. §763.12

Seller and buyer may modify to lower interest rate and installments without approval

Written approval required from agency to: defer installments, lease or sublease, transfer and assumption and assignment. Must justify feasibility of modification.



# PROMPT PAYMENT GUARANTEE

## Loss Limits, guarantee period and conditions

1. Max loss amount: 3 amortized annual installments or equal amount plus taxes and insurance incurred during period covered 7 C.F.R §763.11(a)
2. Guarantee period max 10 years from effective date §763.11(b)
3. Seller must: select an escrow agent to receive land contract payments; notify Agency of buyer default; make a demand upon Agency to pay the missed payment; perform other servicing duties. §763.18



# PROMPT PAYMENT GUARANTEE

## Default

1. Escrow agent must make written demand to buyer for payment within 30 days of missed payment, taxes, or insurance and send a copy of the demand letter to the Agency and to the seller §763.20(a)
2. Escrow agent must make written demand of the Agency within 90 days from the original payment, taxes or insurance due date, for the missed payment if buyer has not paid. §763.20(a)(2)
3. Any amount paid by the Agency as a result of an approved loss claim is immediately due and payable by the buyer. If debt not restructured into payment plan, Agency may use all remedies available to collect the debt. Debt may be rescheduled for repayment consistent with buyer's ability to pay, not to exceed 7 years. §763.21



# PROMPT PAYMENT GUARANTEE

- Agency will cover only 3 missed payments
- During this period, buyer retains possession of land
- 4<sup>th</sup> default means seller's rights dictated by the contract and state law
- If the contract and state law favor forfeiture provisions, buyer must vacate property and lose any payments made
- State law or contract may require some restitution to buyer



# STANDARD GUARANTEE PLAN

## Guarantee period and conditions

1. 10 year max guarantee period 7 C.F.R. §763.11(b)
2. Guarantee covers max 90% of outstanding principal balance §763.11(a)(2)
3. Seller must: use Agency approved 3<sup>rd</sup> party servicing agent; provide proof of property tax payment to Agency; physically inspect farm annually; Get balance sheet, income statement and cash flow annually; notify Agency of buyer default; service delinquent accounts §763.18(b)





# STANDARD GUARANTEE PLAN

## **Default**

If the buyer fails to pay an annual installment then the seller has the option of either liquidating the property or having the loss amount established by the Agency by an appraisal of the real estate.

7 C.F.R. §763.20(b)

Written demand from servicing agent within 30 days

Non payment within 60 days of demand letter, servicing agent informs Agency whether seller will utilize liquidation method or appraisal

7 C.F.R. 763.20(b)(1)



# STANDARD GUARANTEE PLAN

## **Liquidation Method:**

Liquidation plan, complete liquidation within 12 months of missed payment, unless prevented by bankruptcy, redemption rights, or other legal action. Credit an amount equal to the sales price received in liquidation to the principal balance of the land contract. §763.20(b)(2)(i)

## **Appraisal Method:**

Agency appraisal on real estate, loss claim based on difference between appraised value at the time of loss, and unpaid principal balance of land contract. Agency retains a lien on property in amount of the loss claim. If property sells within 5 years of loss payment, seller must repay Agency difference, up to the amount of the loss claim. §763.20(b)(2)(ii)



# STANDARD GUARANTEE PLAN

Any amount paid by the Agency as a result of an approved loss claim is immediately due and payable by the buyer. If the debt is not restructured into a payment plan the Agency may use all remedies available to collect the debt. The debt may be rescheduled for repayment consistent with the buyer's ability to pay, not to exceed 7 years. 7 C.F.R. §763.21

FSA will ensure that seller gets benefit of the bargain. Buyer's rights in default dictated by contract and state law on forfeiture.



# RISK OF BANKRUPTCY

- Debtors in Bankruptcy are allowed to “assume, assign or reject” executory contracts.
- **Seller in Bankruptcy**  
Certain protections to buyers under a land contract.  
If the buyer is in possession, the buyer has the option of terminating the contract or remaining in possession and continue to make the payments. The Bankruptcy trustee will receive payments and deliver title to the buyer when all the payments have been made. 11 U.S.C. §365.
- **Buyer in Bankruptcy**  
Less clarity. Land contract maybe treated as an executory contract or as a mortgage. If the latter, the seller will have a security interest in the land up to the value of the land. If the seller is undersecured, the balance of claim is treated as an unsecured debt and a large portion of it may be subject to discharge.
- If the land contract is treated as an executory contract the buyer must assume, reject or assign the contract without modifying its terms or discharging any of the debt. Bankruptcy Courts will look to state law in deciding whether to characterize a land contract as a mortgage or an executory contract.



# IN PRACTICE

- See Checklist p. 11 of Land Contract materials
- In contract set forth clear and explicit expectations for both buyer and seller in case of default
- Know the governing law in your state as to forfeiture clauses



# POLICY CONSIDERATIONS

- Clarity and certainty for both Seller and Buyer
- Best practices: Land Contract State Statute (like Maine) but with proviso that forfeitures must approximate actual damages
  - Maine clarification about residential property and farmland  
14 M.R.S. §6111.1

