

## LEGAL IMPLICATIONS OF LAND CONTRACTS

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Instead of leasing, some real estate owners/investors choose to sell their real estate pursuant to a land contract. This article reminds owners/investors and prospective purchasers to carefully evaluate this arrangement as it affects the rights of both parties and the owner's recourse in the unfortunate event of a default.

Under a land contract, the owner ("vendor") essentially finances the prospective purchaser's ("vendee") purchase of the subject real estate up to a certain deadline (i.e. 3 years) whereby the vendee must obtain financing to satisfy the remaining amount due and owing under the contract (the "balloon payment"). Prior to this balloon payment deadline, the vendee typically provides the vendor a down-payment of a percentage of the purchase price, and makes monthly payments to be credited towards the purchase price of the real estate. Similar to (most) renters, at the time of the agreement, the vendee does not have the credit to obtain traditional financing and thus needs this type of arrangement to potentially purchase the real estate.

Although this land contract arrangement can create an optimal scenario in which the vendor obtains a healthy return on his or her real estate investment and, in turn, the vendee obtains real estate he or she would have been unable to otherwise purchase, sometimes the vendee defaults on the land contract by failing to make the monthly payments or obtaining the necessary financing to satisfy the balloon payment. If this issue cannot be resolved, the owner will seek to regain possession of their real estate by removing the prospective purchaser from the property. Some owners make the mistake of filing a Complaint for Immediate Possession (typically in small claims court), which is not an available option. Instead, there are two legal options available to an owner seeking to regain his or her property under a land contract – (a) seek a remedy of forfeiture; and/or (b) enforce the contract and seek a foreclosure.

The most expedient way to 'evict' a vendee is through a forfeiture action, but this course of action may not be available to the vendor. Indiana courts always consider the payments and improvements vendees put towards the real estate at issue. This fact sensitive inquiry dictates whether the vendor can pursue a forfeiture action or whether it must treat the vendee like a mortgagee, and pursue a foreclosure action. Indiana Courts have held that in all but a few instances, the proper relief for the owner upon the vendee's default of a land contract is not a forfeiture, but a judgment of foreclosure. For example, forfeiture is unavailable when the vendee has paid approximately five percent (5%) of the purchase price. See *Dempsey v. Carter*, 797 N.E.2d 268, 276-77 (Ind. Ct. App. 2003). Conversely, forfeiture is an appropriate remedy when the vendee has paid less than one percent (1%) of the purchase price. See *Hooker v. Norbu*, 899 N.E.2d 655, 659 (Ind. Ct. App. 2008). Also, it is very important to note that forfeiture terminates the land contract without restitution. This means if the vendor pursues a forfeiture action, he or she can no longer enforce the contract and is not entitled to unpaid installments and other unpaid contractual obligations such as property taxes, insurance or attorney's fees. The vendor can only retain the payments made by the vendee and recoup actual damages sustained as a result of the transaction.

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Foreclosure is typically a more arduous process requiring the vendor to file a complaint, move for judgment, obtain from the Court a Decree of Foreclosure, submit the same to the County Sheriff for a foreclosure sale, attend a foreclosure sale, and obtain a deficiency judgment for the unpaid contract balance, interest, attorney's fees (if available), etc. The foreclosure process takes months and can be furthered delayed by the vendee - - during the foreclosure process, the vendee can file extensions of time to respond to pleadings and other filings and/or could try to file for bankruptcy, which, if successful, results in an automatic stay of the foreclosure proceedings. To resume the foreclosure process, the vendor would need to appear in the bankruptcy matter and seek relief from the automatic stay, which obviously costs additional time and money. As stated above, foreclosure may be the only option available to the vendor. But if it is not, it is important to keep in mind that if the vendor decides to seek foreclosure, the land contract is not cancelled and the vendor can obtain judgment on the amounts due and owing pursuant to its terms. Depending on the vendor's and vendee's circumstances, seeking foreclosure may be a desirable option.

Owners seeking to provide prospective purchasers an opportunity to purchase their real estate, but wishing to avoid the aforementioned legal implications of a land contract, could consider other arrangements such as a lease with an option to purchase. As stated by the Indiana Court of Appeals, a properly drafted lease with option to purchase maintains its character as a lease:

“[a] contract, which contains all the essentials of a lease, and also a provision for the purchase and sale of the land by the lessee upon compliance with its provisions, does not destroy the lease and prevent the existence of the relationship of landlord and tenant, although the payments made as rent are to be credited upon the purchase price if the option is exercised.”

*Hunter v. Smith*, 172 N.E. 926 (Ind. Ct. App. 1930). Thus, by entering into a properly drafted lease with option to purchase, an owner and prospective purchaser enters into an uncompromised landlord/tenant relationship. As a landlord, the owner does not lose the right to expeditiously regain possession of the property in the event of a default (for example, by filing a complaint for immediate possession of the real estate) and seek damages pursuant to the agreement. If this option is pursued, it is important that the lease with option to purchase contains all the essential terms for a lease, clarifies that the prospective purchaser does not own and/or have any equity rights in the property, clearly sets forth the terms of the tenant's option to purchase the real estate and the ramifications if the option is not exercised.