

SIGNIFICANT REVISIONS TO STANDARD OFFER TO PURCHASE AND CONTRACT

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Mortgage lenders and brokers should be aware that significant changes to the standard Offer to Purchase and Contract (form 2-T) have been approved by the NC Association of REALTORS® and the NC Bar Association. Among other changes, the revised version of the form will no longer contain separate loan or appraisal contingencies.

Content and format. A great deal of the content of the current form (copyright 7/2008) has been carried forward into the new form. The organization of the current form has also been significantly changed to group related provisions in a more logical way. For example, defined terms are grouped together in a new “Terms and Definitions” paragraph at the beginning of the new form, and buyer and seller representations and obligations are grouped together in paragraphs 5 through 8.

“Alternative 1” replaced with “due diligence” approach. The revised form eliminates the current “Alternative 1.” Doing away with Alternative 1’s complicated repair negotiation structure will help reduce many of the disputes that have frequently been stumbling blocks to the negotiation of repairs, including disputes over whether an item is “covered” under the list of items in Alternative 1, whether an item is “performing the function for which intended” or is “in need of immediate repair,” whether repair requests and responses to repair requests are timely, whether an item is includable under the Cost of Repair Contingency, whether the estimated cost of repairs is reasonable, and whether and when a contract is “over” following a breakdown in repair negotiations.

Replacing Alternative 1 is a new “Buyer’s Due Diligence Process” paragraph (paragraph 4). During an agreed-upon “Due Diligence Period,” the buyer will have the opportunity to investigate the property and the transaction to decide whether the buyer will proceed with or terminate the contract. Prior to the expiration of the Due Diligence Period, the buyer may terminate the contract for any reason or no reason by written notice to the seller. If the buyer decides to terminate, time is “of the essence” regarding the notice of termination.

The new due diligence paragraph is similar to Alternative 2 in the current Offer to Purchase and Contract but differs from it in some important respects. First, unlike Alternative 2, the description of the due diligence process in paragraph 4 in the new form includes a significant amount of guidance to the parties to aid them in understanding the things they should consider doing during the due diligence period. Examples listed of things that the buyer may consider doing during the due diligence period include conducting inspections to determine the condition of improvements on the property, reviewing relevant documents such as restrictive covenants, conducting an appraisal and a survey of the property, investigating current or proposed zoning, the availability and cost of property insurance, potential flood hazards, and pursuing qualification for and approval of any loan that the buyer may need to obtain to purchase the property. The buyer does not have to do all or any of the listed items, but it is important that any of those items that the buyer does choose to do should be done during the due diligence period.

Separate loan condition eliminated. *It is important to understand that there will no longer be an independent loan condition in the contract.* If the buyer has to obtain a loan to purchase the property, the buyer will be entitled to pursue qualification for and approval of the loan during the due diligence period. Depending on the length of time the buyer and seller agree that the due diligence

period will last, it's quite possible that the buyer won't know for sure when the due diligence period expires that the loan will be approved. Thus, prior to the expiration of the due diligence period, the buyer will need to make a decision based on the information the buyer has from their lender at that time whether to terminate or proceed with the transaction. If the buyer terminates the contract, he or she gets the earnest money deposit back. If the buyer proceeds with the transaction and the lender doesn't approve the loan for some reason, the buyer would lose the earnest money deposit if the buyer was unable to close without the loan.

Is it fair to make the buyer put the buyer's earnest money deposit at risk? Recall that the loan condition in the current contract was completely rewritten in 2008. Prior to that time, the loan condition extended right up to the date of closing and if the lender decided not to make the loan at the last minute, the buyer could terminate the contract and get the earnest money deposit back. Many felt this was unfair to the seller. It was felt that the loan condition should be changed to more fairly balance the risk between the buyer and seller of the sale not closing due to the buyer's loan not being approved. This was accomplished by shifting that risk to the buyer at some mutually agreeable date during the transaction. The new due diligence contract uses this same basic approach. The date that the risk shifts to the buyer is the date that the due diligence period expires.

What's a fair period of time to give a buyer to make a decision? The buyer typically would like for this date to fall as close to the closing as possible and the seller typically would like for this date to come sooner in the process. Just as the sales price is negotiable, the date that the buyer has to make a decision to terminate or move forward is a matter of negotiation. The "Note" at the end of paragraph 4(a) in the new Offer to Purchase provides: "Buyer is advised to consult with Buyer's lender prior to signing this offer to assure that the Due Diligence Period allows sufficient time for the appraisal to be completed and for Buyer's lender to provide Buyer sufficient information to decide whether to proceed with or terminate the transaction."

Separate appraisal condition eliminated. *It is also important to note that there is not an independent appraisal contingency in the revised contract.* Determining whether the property appraises is a part of the buyer's due diligence process. This is true whether or not the buyer needs to obtain a loan in order to purchase the property. Any appraisal should therefore be completed prior to the expiration of the due diligence period. If the appraisal is not completed until after the due diligence period has expired, the buyer would not have any right to terminate the contract based on the property appraising for less than the purchase price, which would result in the loss of the buyer's earnest money deposit if the buyer is unable or unwilling to complete the transaction.

Repair negotiation. Regarding the negotiation of repairs, Paragraph 4 in the new form specifically states that the parties may, but are not required to, engage in repair negotiations. There is no limitation on what the buyer can ask the seller to repair, and there is no obligation on the seller's part to repair anything. The buyer is advised to make any repair requests in sufficient time to allow any repair negotiations to be concluded by the end of the due diligence period. There is a "Warning" to the buyer in paragraph 4 that unless the seller agrees in writing to an extension of the due diligence period, the buyer should terminate the contract if the buyer is not satisfied with the results or progress of the buyer's due diligence.

If the buyer chooses not to terminate prior to the end of the due diligence period, the buyer would lose any right to terminate the contract later based on any matter that should have been addressed during the due diligence period. However, the buyer would not lose all rights to terminate after the end of the due diligence period. The "Note" at the end of paragraph 4(g) makes it clear that the buyer would

retain any right to terminate for any other reason permitted under the contract or North Carolina law. For example, if the seller was unable to deliver a deed conveying marketable and insurable title (see paragraph 8(a)), that would be considered a breach of contract by the seller. Paragraph 8(l) specifically provides that the buyer would be entitled to a refund of their earnest money deposit and any due diligence fee, and reimbursement for reasonable costs incurred by the buyer in connection with the buyer's due diligence.

Due Diligence Fee. The "Due Diligence Fee" is defined in paragraph 1 of the new form as "[a] negotiated amount, if any, paid by Buyer to Seller with this Contract for Buyer's right to conduct Due Diligence during the Due Diligence Period" (see paragraph 1(i)). The payment of a due diligence fee is not mandatory under the new version of the Offer to Purchase and Contract. That's the second significant difference between the due diligence provision in the new form and Alternative 2. To address concerns about the enforceability of the contract in situations where no due diligence fee is paid, a mutual waiver of any defense to the enforceability of the contract based on the absence or alleged insufficiency of any due diligence fee has been added at the end of paragraph 1(i).

The amount of the due diligence fee will be influenced by such things as the market for the property and the time it's been on the market, the buyer and seller's personal circumstances, and the length of the due diligence period. In determining how much due diligence fee they are willing to pay, a buyer should clearly understand that the fee is generally non-refundable (with some exceptions listed in the Due Diligence Fee definition) and that the seller is not required to make any repairs to the property or agree to any other concessions that the buyer may request. On the other hand, in deciding how much of a fee to accept, the seller should clearly understand that the buyer may walk away from the transaction for any reason or no reason, even if the seller is willing to fix everything that the buyer may request or agree to any other concessions, and that the due diligence fee is all they are going to get for taking their property off the market during the due diligence period.

Other significant changes. Other significant changes include the following:

- The separate flood hazard condition has been eliminated since investigating potential flood hazards, among other things, will become part of the buyer's due diligence.
- The new form recognizes a distinction between "settlement" and "closing" "Settlement" is when all the documents are signed and delivered to the settlement agent along with the funds necessary to complete the transaction. "Closing" is a process that includes the settlement, as well as the title update following settlement, the settlement agent's receipt of authorization to disburse all necessary funds and the recordation of the deed(s) and any deed(s) of trust (see definitions in paragraphs 1(k) and 1(m)).
- The seller's damages in the event of a breach of the contract by the buyer are limited to the earnest money deposit (see paragraph 1(e)). A seller's damages can be difficult to determine, and unless the contract sales price is greater than the appraised value of the property at the time of the contract, the seller may not have any significant damages if the buyer breaches the contract. Limiting the seller's damages to the earnest money deposit will give the parties greater certainty during the negotiation process about possible outcomes if the transaction doesn't work out.
- An attorney fee provision has been added in paragraph 1(g) in an effort to help discourage frivolous disputes over earnest money.
- The separate "Fuel" provision and the necessity of measuring the amount of fuel in any tank(s) prior to closing has been eliminated. In the new form, the buyer will be entitled to whatever fuel may be in the tank(s) at Settlement (see paragraph 2).

- New representations by the buyer have been added regarding other property that the buyer may need to sell and the buyer's financial ability to complete the transaction (see paragraphs 5(b) and 5(c)).
- New representations by the seller have been added regarding length of the seller's ownership of the property, whether the property is the seller's primary residence and whether there is an owners' association (see paragraphs 7(a), 7(b) and 7(e)). The length-of-ownership representation has been added in response to loan underwriting guidelines which now commonly require that a seller has owned the property for a minimum period of time. The representation regarding primary residence was added as a result of a new North Carolina law that requires a statement whether the property includes the seller's primary residence to be included in a deed conveying the property
- The new form *requires* the attachment of an "Owners' Association Addendum" if there is an owners' association (see paragraphs 7(e) and 8(k)).
- The existing "Delay in Closing" provision has been simplified as a result of confusion about how it worked and a few reported problems associated with the payment of accrued per diem interest. In the new form, the per diem interest provision has been eliminated and the permitted delay shortened to fourteen days (see paragraph 13).
- In the "Fixtures" paragraph, "range/stove/oven" has been added to the list of fixtures to address the common understanding between the parties that such a device generally remains with the property. This addition will eliminate the need to add such a device in the Personal Property paragraph of the contract. In addition, the word "attached" has been added in front of "wall and/or door mirrors" primarily to distinguish bathroom mirrors that are hung like pictures from those that are attached to the wall in a more permanent way.

Effective date of new form. The new Offer to Purchase and Contract will be released by the Bar Association and the NC REALTORS® effective January 1, 2011. Corresponding changes have been made to the Offer to Purchase and Contract—Vacant Lot/Land (form 12-T) and the *Guidelines* for completing both forms have been updated. The various addenda to the Offer to Purchase have been updated and a new, separate Offer to Purchase and Contract for new construction is being developed.

A "Sample" of the new Offer to Purchase and Contract is available via the following link: <http://www.ncrealtors.org/uploads/050310sample2-T.pdf>.

*Bob Ramseur and Miriam Baer are members of the Real Property Section Council of the NC Bar Association and are co-chairs of the Joint Forms Task Force, which is responsible for maintaining residential forms that are jointly-approved by the Bar Association and the NC Association of REALTORS. Will Martin is a member of the Real Property Section and the Joint Forms Task Force and acts as NCAR's General Counsel.