



Michigan Land Contract Guide

Important Disclaimer:

The information in this guide is meant to be educational and general in nature. It does not replace the advice of an attorney.

Why a Land Contract Guide Now?

One of the impacts of the foreclosure crisis has been the increase in the use of land contracts as a way to buy or sell a home. A land contract can provide a way for a homebuyer who cannot qualify for conventional financing to purchase a home. It can also provide a way for seller to be more likely to sell a home and sell it at a price closer to its perceived value than an appraisal would reflect. While a land contract can be a viable and valuable alternative to traditional financing, it can also cause significant problems for both buyers and sellers who do not understand the basics and who enter into a poorly crafted contract. The purpose of this guide is to provide those basics and a check list of those considerations and provisions that make for a well-crafted Land Contract in the state of Michigan. **It does not replace the advice of an attorney.**

What is a Land Contract?

A land contract is an agreement between a buyer and a seller that states the buyer is purchasing property but will not receive the legal title until the debt has been satisfied. Land contracts are a form of seller financing and are typically used in real estate transactions, usually residential, when a buyer cannot secure traditional means of financing. Unlike a mortgage, a land contract stipulates that if a buyer does not fulfill his financial obligations in the agreed upon terms of the contract, then the seller regains possession of the property and keeps whatever money the buyer has remitted. Land contracts are legal and binding in Michigan and must be in writing in order to be enforced. Enforcement is governed by Michigan law and falls under the general category of contract law. If any party involved in the land contract transaction does not meet the terms of the contract anytime during the term of the agreement, the contract is rendered invalid due to breach of contract rules.

What Distinguishes Land Contracts in Michigan?

There are some basic principles that distinguish Michigan land contracts from purchase agreements and/or land contracts used in other states. In many respects, Michigan land contracts are more like a mortgage than a purchase contract. This is because they typically grant purchasers immediate possession and control of the property. Under a typical Michigan land contract, purchasers also immediately obtain

Equitable title while *Legal* title remains with the seller. It should be noted, however, that there is very little difference between holding *Equitable* title to the property and holding *Legal* title to the property since under *Equitable* title, the property can be bought, sold, insured, recorded, and encumbered and can be the subject of tax liens and foreclosure.

Why Would Someone Choose to Sell Real Estate Using a Land Contract?

There are several reasons someone might choose to sell real estate using a land contract. Here are just a few of the most popular:

- A land contract may make the property easier to sell. Since the seller is the qualifying agent and controls the stipulations of the contract, the seller may set their own requirements for the credit worthiness of the buyer, the amount of the down payment or any other item that might typically be dictated by a bank or some other 3rd party. And, because the seller is setting the terms and conditions, they can establish payments that fit within the buyers budget and utilize the option of accelerating the loan through a balloon payment at some future date.
- There are tax advantages using the installment sale method, as well. Taxes from the sale of a property are usually computed on an income-minus-basis method. With an installment sale, the taxable income can be spread out over a number of years instead of taken in the year of the sale. In other words, you can avoid paying all the capital gains tax at once.
- The seller on a land contract can enjoy a regular cash flow without the headaches of managing rental property.
- The seller may be able to realize a greater overall profit from the sale by earning interest. The seller may charge interest up to 11%. (And, in some cases an even higher rate of interest.)

What should a seller consider before deciding to sell a home on land contract?

1. What do you need as a financial return from the property on a long-term basis and what terms will most likely generate that financial return?
2. How will you determine the creditworthiness of a prospective buyer?
3. You will be taking on the role of a landlord. You will need to understand the methods available to you for enforcing the terms of the land contract as well as the associated costs involved.
4. If you have a mortgage on the property you wish to sell on land contract, you will need to know if a land contract will present any legal or practical problems with your mortgage lender.

What should a buyer consider before deciding to sell a home on land contract?

1. What can you afford to pay as a down payment and thereafter in monthly installments?
2. If you enter into a land contract with a balloon payment, what is your plan for being able to come up with the payment?
3. You need to understand the legal remedies available to the seller if you are declared in default
4. If there is an underlying mortgage on the property you wish to buy and it is going to remain on the property during the term of the land contract, you will need to understand what, if any legal issues that can arise between the seller and the seller's lender.

What provisions should be included in a *Legal and Well-Crafted Michigan Land Contract*?

There is no standard land contract *form* in Michigan but a land contract must satisfy the Statute of Frauds in addition to meeting general contract principles, which include offer, acceptance, consideration, competency

to contract, and a definite statement of the credit terms. A well-crafted Michigan land contract, however, should go beyond those basic to include the following provisions:

1. **All payment terms** including down payment, remaining balance, amount of monthly installments, the interest rate, the number of years of the land contract and any specific date for a balloon payment.
2. **Provision that gives the buyer possession of the property** during the term of the land contract. If this is not included, then possession remains with the seller.
3. **Provision indicating that the buyer had received a title insurance policy covering the property** and that the buyer accepts the condition of the title as disclosed in the policy. Note: Make sure the Title Insurance is reviewed to find out if:
 - a. There is an underlying mortgage with a due on sale clause?
 - c. There is an underlying Land Contract with another party?
 - d. There are other liens that might affect marketability of title.
 - e. There are any delinquent taxes, or special assessments.

Make sure that *All* sellers sign Purchase Agreement and Land Contract.

4. **Provision covering property taxes.** It must be determined who will be responsible for paying property taxes during the period of the land contract. The mechanics of this can be handled in a number of ways, but in the end the buyer typically pays the taxes either directly or indirectly. It is a good idea to include language requiring the party paying the taxes to provide evidence to the other party that the taxes have been paid.
5. **Provision requiring the seller to deliver a warranty deed to the buyer** upon the buyers' performance to the terms of the land contract. The seller is generally not permitted to place additional easements or other restrictions against the property during the term of the land contract. The seller may except from the warranty any liens caused by the acts or omissions of the buyer during the term of the land contract.
6. **Provision requiring the seller to pay the transfer taxes when delivering the deed to the buyer.** Alternatively the provision could provide that the buyer deduct the amount of the transfer taxes from the final installment(s) on the land contract and pay the transfer taxes when the buyer records the deed.
7. **Provisions with respect to liability and casualty insurance.** The seller will certainly want insurance on the property during the term of the land contract to assure payment if the property is damaged or destroyed. The land contract should provide for who will pay the insurance (buyer or seller) and whether or not the paying party will be required to provide evidence of payment to the other party.
8. **Provision specifying whether the buyer can or cannot transfer its interest in the land contract without the prior consent of the seller.** As importantly, the provision should specify whether the buyer will or will not remain liable under the land contract after the transfer.
9. **Provision requiring the buyer to maintain the property in good condition,** reasonable wear and tear excepted. As a corollary, there should be a provision acknowledging that the buyer has purchased the property in "as is" condition.
10. **Provision addressing whether or not a buyer can make substantial changes to the property without the consent of the seller**
11. **Provision regarding the seller's right to place mortgages on the property.** It must be remembered that the seller still has legal title. If the seller is going to be permitted to place a

mortgage on the property, the contract typically provides that the mortgage amount shall not exceed the balance owed under the land contract. On addition, the contract typically provides that the amount of monthly payments of interest and principal on the mortgage cannot exceed the amount of monthly payments required under the land contract. These provisions are essential in the event that the buyer wishes to assume the seller's mortgage or is required to step into the shoes of the seller with respect to that mortgage.

12. **Provision spelling out the legal remedies permitted the seller in the event the buyer defaults under the terms of the land contract.** These typically include three options:
 - A. Sue for Breach of Contract (available to seller even if not spelled out in the contract)
 - B. Forfeiture of the land contract (ONLY if included in the contract)
 - C. Foreclosure on and sale of the land contract property (available to seller even if not spelled out in the contract)
13. **Provision specifying that upon execution, the land contract will become part of the public record by being recorded with the County Register of Deeds.**

Additionally, make sure the Land Contract is prepared pursuant to the purchase agreement. Some Land Contracts are prepared using a standard form and are not modified to cover the actual terms of the purchase agreement.

When closing on a Land Contract:

- 1) If there is an underlying Land Contract or Mortgage, you must get verification in writing that the debt is current and what the current balance is. Also, discuss with Buyer and Seller how to assure that the underlying debt payments are kept current after your closing.
- 2) Make sure that if the Land Contract calls for a principle reduction payment that it does not cause the Land Contract balance to be lower than the underlying Mortgage.
- 3) You should discuss the fact that Revenue Stamps must be paid by the Seller when the Land Contract is paid off. Should this clause be put in the Land Contract?
- 4) Make sure Buyers and Sellers understand that when the Land Contract is paid off the Seller is obligated to give a Warranty Deed.
- 5) Buyer and Seller need to exchange Social Security or Tax ID numbers for income tax purposes.

Additionally, be cautious of a contract being written from an out-of-state company and ALWAYS seek legal advice before you sign.

What Happens When a Buyer Defaults on a Land Contract in Michigan?

In general, both buyer and seller may be able to avoid problems if they talk to each other when concerns arise. In the even that this doesn't work, however, a seller must use the court system in order to regain possession of the property and evict a land contract buyer who has failed to meet the requirements of the land contract. When a buyer defaults by either failing to make payment or some other breach of the land contract, the seller should first look to the remedies spelled out in the provisions of the contract. Generally, the contract will give the seller the three remedies listed under 12) above:

- 1) **Sue for Breach of Contract** (available to seller even if not spelled out in the contract)
- 2) **Forfeiture** of the land contract (ONLY if included in the contract)
A Seller may regain possession of land contract property by **Forfeiture** if:
 - The land contract expressly provides for forfeiture and termination of the contract and

- The buyer has failed to make payment of any moneys required to be paid under the land contract, or has materially breached the land contract (Example: a failure to pay real estate taxes or to keep the property insured.)
- 3) **Foreclosure** on and sale of the land contract property (available to seller even if not spelled out in the contract)

Land contract Foreclosure in Michigan is generally a more complicated and lengthy remedy to regain possession of the property than forfeiture. A significant difference between forfeiture and foreclosure is that in a Forfeiture, a buyer may prevent the loss of the property by merely paying past due installments, while in foreclosure, the buyer may be required to pay the entire balance due under the land contract. In addition, in foreclosure even if the property is returned to the seller, the buyer may remain liable to the seller for the portion of the balance due under the land contract which was not satisfied by the sale of the property. Land contract foreclosure in Michigan differs from Mortgage foreclosure in that the seller cannot foreclosure by advertisement and must foreclosure through the courts.

What Happens When a Seller Defaults on a Land Contract in Michigan?

Generally, upon a buyer's fulfillment of the land contract, the seller should give the required deed conveying the property free of liens created by the seller. A seller who fails to provide the required deed may be in breach of the contract. If the seller is unwilling or unable to give the required deed the buyer may have various options including legal action for:

- 1) Specific performance of the land contract (including a court order directing the seller to give the required deed);
- 2) Quiet title;
- 3) Cancellation of the land contract (seeking the return of the money paid by the buyer in exchange for all of the buyer's rights in the property);
- 4) Money damages.

Some Land Contract Terms You Should Know:

Balloon Payment - An unusually large payment due at the end of a mortgage or loan. Since the payments are not spread out, this large sum is the final repayment to the lender. Holding back most of a debt and paying it only towards the end of the agreement makes both those last payments and the total amount repaid much larger. The name comes from the fact that the debt becomes inflated like a balloon as a result of the compound interest accumulating on the large sum.

Due on Sale Clause - A clause in a loan or promissory note that stipulates that the full balance may be called due upon sale or transfer of ownership of the property used to secure the note. The lender has the right, but not the obligation, to call the note due in such a circumstance.

Equitable Title - The right to obtain full ownership of property, where another maintains legal title to the property.

Full Legal Title - The actual ownership of the property. When a contract for the sale of land is executed, equitable title passes to the buyer. When the conditions on the sale contract have been met, legal title passes to the buyer in what is known as closing. Legal and equitable title also arises in trust.

Quiet Title - An action to quiet title is a lawsuit brought in a court having jurisdiction over land disputes, in order to establish a party's title to real property against anyone and everyone, and thus "quiet" any challenges or claims to the title. This legal action is "brought to remove a cloud on the title" so that plaintiff may forever be free of claims against the property.

Vendor – Term used for the seller

Vendee – Term used for the buyer

Warranty Deed - A type of deed where the grantor (seller) guarantees that he or she holds clear title to a piece of real estate and has a right to sell it to the grantee (buyer). The guarantee is not limited to the time the grantor owned the property—it extends back to the property's origins.

NOTE: This information is not a substitute for legal advice. If you need legal advice, see a lawyer.