INSTALLMENT LAND CONTRACTS FOR FARMLAND

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N. G. P. KRAUSZ
EXTENSION SERVICE IN AGRICULTURE AND HOME ECONOMICS
UNIVERSITY OF ILLINOIS COLLEGE OF AGRICULTURE
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INSTALLMENT LAND CONTRACTS FOR FARMLAND

By N. G. P. Krausz, Professor of Agricultural Law

Buy now, pay later’ has become a familiar phrase in this country. Millions of Americans have discovered that, through installment buying, they can enjoy the advantages of immediate ownership while making payments over a period of time. Installment buying has been widely publicized as a means of purchasing “goods,” but many Illinois farmers do not realize that the same principle can be applied to the acquisition and sale of farmland.

The usual methods of selling farmland are —

1. Straight cash sale. The buyer pays the entire purchase price to the seller in exchange for an absolute deed.

2. Mortgage agreement with the seller. The buyer pays a substantial portion of the purchase price to the seller. The seller then gives the buyer a deed, receiving in return a purchase-money mortgage to secure the balance.

3. Mortgage agreement with a third-party lender. The buyer borrows a part of the purchase price from a third party, pays the seller in full, receives a deed, and executes a mortgage of the land to the third party.

A fourth method, little used in some parts of the state, is known by various names, such as “contract for deed” and “bond for deed.” However, it is most correctly called an installment land contract. It allows the buyer to become the beneficial owner immediately upon making a down payment. The seller retains legal title as security for the payment of the remaining installments.

Advantages of the Installment Land Contract

Advantages to the buyer

Low down payment. Down payments are generally much lower under an installment land contract than when financing with a loan and mortgage. A survey of installment land contracts in Illinois shows that the down payment usually ranges from 10 percent to 30 percent of the purchase price.

Installments often equivalent to rent. Frequently the yearly installments can be arranged so that they are equal to or even slightly lower than the amount the purchaser could expect to pay if he were
renting the farm. The buyer, of course, assumes a number of new obligations such as repairs, taxes, and insurance.

Safety in making permanent improvements. Since the buyer is the beneficial owner and expects to acquire full legal title, he can make permanent improvements on the land with reasonable assurance that they will not be lost.

All profits belong to buyer. As beneficial owner, the buyer takes all profits from the farm and must meet only his installment obligations to the seller; no rent is paid.

Interest rates may be lower. It is possible, particularly in family arrangements, to secure lower interest rates than if funds were borrowed from an outside source.

Advantages to the seller

Probable savings on income and estate taxes. In most cases, the seller will have a capital gain from the sale to be reported on his federal income-tax return. By spreading this gain over a number of years, he will usually reduce the total tax paid.

If the seller uses the installments for living or for gifts, substantial federal estate-tax savings may be effected. In addition, administration expenses for the estate are smaller. See pages 15 and 16 for a fuller treatment of income- and estate-tax considerations.

Retention of investment in the farm. For many people, their farmland represents future economic security. A complete sale for cash usually requires immediate reinvestment of the money received. The land contract offers the seller an opportunity to retain a large part of his investment in his land for a period of time.

An annuity for retirement. Regular installment payments from the buyer may represent a desirable annuity program for the seller. Farm income fluctuates from year to year, but installments remain the same, allowing long-range retirement planning.

Interest as income. Interest on the unpaid balance of the purchase price supplements income and may provide a substantial part of the seller's living expenses during the early years of the contract.

Ease in making family transfers. The installment land contract is especially useful for the inter-family transfer of a part of the land because it permits the seller to maintain some supervision and control over the operation of the farm before the farm is completely transferred. It settles title to the property, and the children can make improvements immediately rather than after they get the land by inheritance.
Disadvantages of the Installment Land Contract

Disadvantages to both buyer and seller

Fluctuations in land values. A substantial increase in land values during the life of the contract would be disadvantageous to the seller, and he might well regret not having waited to sell. Similarly, a decrease in land values would be detrimental to the buyer. One solution to this problem (usually more suitable to family contracts) is the use of a revisable-payment plan based on land values. Under this plan, the contract would contain a provision whereby the total purchase price could be revised at regular intervals throughout the life of the contract.

As an illustration of how the plan would work, assume that the contract price of the farm is $40,000, and that the parties agree to adjust the price every three years on a 15-year contract:

| Latest available average land-index number | 140 |
| Latest available average land-index number three years later | 147 |
| Difference | +7 |

\[ 7 = 5\text{-percent change} \]

\[ 5\text{ percent} \times 40,000 = 2,000 \times 80 \text{ percent (percent of the contract remaining)} = 1,600 \text{ to be added to principal} \]

Purchase price | $40,000 |
Amount to be added to principal | 1,600 |
Adjusted principal | $41,600 |

The amount added to the principal would then be divided, and an equal amount would be added to each of the future installments. As explained in the tax section (pages 15 and 16), the seller will want to place some limitations upon this feature of the contract.

Fluctuations in price of farm products. Adjustments of farm-product prices during the life of the contract may have an effect on the value of the land. The seller may have done better to have rented the farm instead of selling it. However, price fluctuations are more likely to affect the buyer, since sale of products will probably be his primary source of income for installment payments and other expenses. A drastic decrease in prices might cause the buyer to default on the contract. A possible solution would be to incorporate a product-payment plan into the contract. Under this plan, all or an agreed percentage of the annual installments could be satisfied in farm produce, such as milk or grain.

Fluctuations in interest rates. Over the life of the contract, changes in interest rates would also be of concern to both parties. A
difference of 2 percent on a $80,000 contract can mean a difference of
$16,000 in interest paid over a 20-year period. The buyer and seller
can anticipate such an event in a manner similar to that used in making
adjustments to the principal. They might, for example, agree to use
the average interest rate on first-mortgage loans on farm real estate
for Illinois as computed by the U. S. Department of Agriculture, the
rate to be applied at regular intervals as determined by the parties in
their contract.

These three devices for lessening the risks of economic fluctuations —
the revisable payment plan, the product-payment plan, and the ad¬
justable interest rate — are not widely used in Illinois. Their value
lies in the flexibility they may give to the individual contract, and it is
recommended that they be incorporated only when it is deemed advan¬
tageous to do so by the parties to the individual transaction concerned.
Usually families would be most interested in such provisions to provide
a hedge for nonbuying heirs against increases in land values.

**Disadvantages to the buyer**

*Possibility of forfeiture.* If the buyer defaults, he forfeits capital
improvements, and may also forfeit payments already made under the
contract.

*Payment of taxes and other ownership costs.* The buyer is
treated as the owner, and must pay property taxes, maintenance costs,
insurance, etc. When farm income is low, these expenses may be
severe. Some provision for prepayment of installments to enable the
buyer to build a reserve would be helpful.

*Substantial interest cost.* The buyer pays a high interest cost,
particularly at the beginning of the contract, unless the interest is paid
in equal amounts over the life of the contract.

**Disadvantages to the seller**

*Possibility of loss upon buyer’s default.* If the buyer defaults,
the costs of foreclosure and resale may be considerable. However,
these costs are charged to the buyer’s equity, if it is large enough.

*Full purchase price not available for immediate investment.* As
pointed out previously, it may not always be desirable for the seller to
have the entire proceeds of the sale available for investment. Never¬
theless, a contract obligation is substituted for land, probably reducing
the seller’s security if the seller should want to borrow money.
The Legal Positions of Buyer and Seller

Under the contract, the seller retains his legal title as security for performance by the buyer. The buyer acquires the beneficial ownership of the land and, for most purposes, is considered the true owner.1

This "divided ownership" had caused one Illinois court to rule that the buyer, although not yet entitled to a deed, is the true owner. This ruling was based on the doctrine that "that will be regarded as done which ought to be done," thus anticipating the time when the buyer will assume full and exclusive ownership.

Disposition of property on seller's death

If the seller dies before the contract is completed, leaving no will, the right to receive the remaining installments passes to his estate as personal property.

If the seller dies, leaving a will that names beneficiaries to take his personal property, the contract interest passes to the person or persons named.

A more difficult situation arises when the seller has executed a will leaving what he terms "my farm" to a beneficiary. If the seller executed the will prior to the contract, the courts usually rule that by selling the farm, he, in effect, revoked that particular portion of his will. In this case, his contract interest passes as personal property under the will in the same way as if he had died without a will.

If the seller executes the will after having sold the farm, the courts have decided that the seller really meant to give his rights under the contract, in which case the beneficiary or beneficiaries will acquire a right to the proceeds.

When the seller and his wife own the farm as joint tenants at the time of the contract, the joint tenancy is controlling, and the survivor acquires the right to receive the remainder of the installments due under the contract.

Disposition of property on buyer's death

At death of the buyer, the farm property passes as real estate. The installment obligations under the contract are a debt of the estate, to be paid as any other debt of the estate. This can mean a substantial benefit to those heirs taking the real estate at the expense of heirs.

1 In law, upon the formation of a valid contract for the sale of an interest in land, the buyer acquires what is known as "equitable ownership" of the land.
taking personal property. In such cases, the probate court has the power to direct that payments be made by the heirs receiving the land.

If the buyer and his wife acquire their interest as joint tenants, the interest of the buyer passes to the wife automatically upon his death, even if there are contrary provisions in his will.

**Buyer’s right to possession**

If there is nothing in the contract clearly showing who is entitled to possession, the buyer is not entitled to possession until the entire purchase price has been paid and the deed delivered to the buyer. However, the courts will allow possession if the intention to give this right to the buyer is evident from the contract — i.e., duty upon the buyer to make repairs and pay taxes. The best solution is to write the contract to cover possession date.

Once it is determined that the buyer has the right to possession, the law provides that, in the absence of any limitations in the contract, the buyer’s rights to use and enjoyment of the land are as full and complete as if he were the sole and absolute owner. In theory, at least, the buyer may bring an action for trespass against the seller himself if he comes upon the land without permission. An exception might be an inspection to ascertain if the buyer is committing waste.

**Buyer’s duty to prevent waste**

When the buyer is lawfully in possession, he may make all decisions regarding the management and operation of the farm unless the contract provides otherwise.

There is, however, one qualification to the buyer’s complete control. This is the right of the seller to prevent the buyer from committing acts that substantially impair the seller’s security interest in the farm. The law refers to such acts as *waste*. For example, if the buyer, without permission or consent of the seller, were to cut valuable trees, remove buildings or allow them to fall into serious disrepair, or to follow improper crop practices that substantially reduced the fertility of the soil, the seller would have a right to obtain a decree from a court demanding that the buyer refrain from such acts.

Contracts usually contain a general provision relating to these matters. When the down payment is low, the parties should discuss crop rotations, conservation practices, building maintenance, and any other problems regarding the management and operation of the farm before the contract is drafted. They may wish to stipulate in the contract certain instances in which the buyer’s operating decisions should
be subject to the seller's approval. Well-defined agreements at the outset can save future disputes and misunderstandings.

The law places a duty on the buyer not to allow buildings and improvements to fall into disrepair. Since this duty is not well defined in the law, however, there should be a clause in the contract covering the buyer's obligations.

As a general rule, the purchaser is liable to third parties who are injured because of defects in the premises. The seller, however, may be liable to both the buyer and third parties if he is aware of hidden defects in the premises that cause the injury and fails to warn the buyer of these defects.

**Buyer's duty to pay taxes**

The payment of taxes and assessments levied on the farm during the term of the contract is another duty that passes to the buyer in possession. In the year of transfer, the party who receives the profits from the farming operation usually bears the entire property-tax burden, regardless of when the buyer went into actual possession of the farm. The income tax, however, requires that the property-tax deduction be apportioned between the seller and buyer according to the time of year the sale was made, regardless of whether the parties actually apportioned the tax.

It is common practice to insert a provision in the contract that if the buyer fails to pay property taxes, the seller may do so. Any amounts expended by the seller are then added, along with interest, to the amount due from the buyer under the contract.

**Risk of loss and insurance**

Another aspect of the buyer's "beneficial ownership" is that he usually bears the risk of loss caused by fire, wind, and floods. However, the seller is interested in seeing that there is adequate insurance coverage, since he is relying on the value of the land and improvements as security for the purchase price. Therefore, unless the down payment exceeds the value of the improvements, the contract should place a duty on the buyer to maintain insurance on buildings.

The typical insurance clause requires coverage with a reputable insurance company payable to both parties. The seller often agrees to assign his existing insurance to the buyer, who agrees to pay the seller for his proportional share of the premium for the unexpired term.

There should be a provision in the contract that in the event of loss the insurance proceeds will be applied either to the replacement or
repair of the structure destroyed or damaged, or to the unpaid balance due the seller under the contract.

To minimize the risk of a misunderstanding or failure to maintain insurance, the contract should require the policies to be deposited with the escrow agent.

As in the case of taxes, it is also common to provide that if the purchaser fails to pay the insurance premium, the seller may do so himself, the amounts expended to be added to the balance due with interest.

**Oil, gas, and mineral rights**

In the absence of a provision in the contract, neither the buyer alone nor the seller alone has the right to remove oil, gas, or mineral deposits from the realty nor lease the mineral estate to third parties during the contract term. For this reason, especially in areas of oil and gas development, the parties should agree on rights to minerals and incorporate this agreement into the contract.

**Rights of creditors**

When one person obtains a judgment against another in a court of law, the judgment becomes a lien on the debtor's legal and equitable interests in any real estate. Therefore, those holding judgments against the buyer would be able to acquire a lien against the buyer's beneficial ownership in the property. In most states, the contract interest of the seller can also be reached by creditors, and Illinois appears to follow the majority.

Persons who furnish labor and material for improvements to Illinois real estate acquire a lien upon such real estate to the extent of the amounts expended. If improvements are made by the buyer during the term of an installment land contract, the buyer's interest is subject to the lien. Furthermore, if the improvements are made with the implied consent of the seller, then his security interest is also subject to the lien. His consent may be implied if he merely allows the work to be done and makes no objection.

The seller can protect himself by insisting that the contract contain a clause requiring the buyer to obtain the seller's written consent before anything is done on the premises out of which such a lien might arise. Although not a complete solution to the problem, such a clause would at least give the seller an opportunity to assure himself of the buyer's ability to pay for the improvements. If the buyer violated this clause, the seller would have such remedies against the buyer as pro-
vided in the contract, including the possibility of declaring a forfeiture of the contract.

**Right to assign and mortgage**

Unless the contract provides otherwise, either party may sell or assign his interest, and the assignee acquires the same interest in the land as that held by the original party. When the seller assigns his interest, the assignee acquires the right to receive the purchase price from the buyer. Similarly, an assignee of the buyer acquires the right to receive the deed from the seller as provided in the contract.

It does not follow, however, that because the buyer has assigned his interest, he is no longer under any obligation to the seller. Unless the seller has agreed to release him, he may still hold the original buyer responsible for payment of the purchase price.

Sellers frequently want to include a provision that prohibits assignment by the buyer without the prior consent of the seller. The same result can be obtained by inserting an option clause under which the seller is to be given the first opportunity to purchase the farm if the buyer decides to sell during the contract term.

A provision that the contract shall be obligatory upon the heirs and assigns of the parties is standard in installment land contracts. This provision is simply a statement of what the law would be in the absence of such a provision. It does, however, direct the attention of the parties to this aspect of their obligation.

What has been said with respect to assignment is equally applicable to a mortgage. In the absence of a contract provision to the contrary, either party has the power to mortgage his interest in the farm. The mortgagee, of course, acquires no greater interest than the mortgagor has under the contract.

**Default on the Contract**

**Buyer in default**

Usually the installment land contract provides that if the buyer defaults in the performance of the contract, the seller shall have the right to declare a forfeiture of the buyer's interest. In some cases, such a provision will be enforced by the courts — the seller can declare the buyer's interest at an end, retake possession of the land along with the buyer's improvements, and keep the amounts paid by the buyer as damages. To recover possession, the seller usually gives a 30-day written notice demanding possession because of the buyer's default (stating the nature of the default), and then uses the legal


remedy of forcible entry and detainer if the buyer does not leave. However, three considerations must be taken into account:

1. The nature of the buyer's default.
2. The extent of the seller's loss.
3. Whether the seller has completely complied with the terms of the contract in declaring the forfeiture.

Each of these considerations has been discussed by Illinois courts.

**The nature of the buyer's default.** Most contracts contain a “time is of the essence” clause, meaning that everything must be performed exactly at the time called for in the contract. These clauses, usually inserted for the seller's benefit, have been narrowly applied by the courts. For example, courts often find that such clauses are “waived” by the seller when he has repeatedly accepted late payments. The seller may be able to change this situation by giving notice to the buyer that he will no longer accept late payments.

The buyer's departure from the terms of the contract must be substantial, and a forfeiture is not justified in the case of minor non-compliance. If the seller declares a forfeiture when he is not justified in doing so, the court may decide that he has rescinded the contract and force him to hand over to the buyer the payments on the purchase price as well as the value of the improvements made by the buyer.

**The extent of the seller's loss.** Even if it is found that the buyer has made a substantial default, the courts usually will not enforce the forfeiture clause if it is found that a penalty would be imposed in doing so.

Assume, for example, that the seller has contracted to sell his farm to the buyer for $40,000, and that the agreement calls for a down payment of $10,000 and 10 annual installments of $3,000 each. The fair rental value of the farm is $1,500 per year. The contract has been in existence for five years, during which time the buyer has made improvements on the farm worth $10,000. Assume also that the seller has incurred $5,000 of recoverable damages as a result of the buyer's default, which occurred at the end of the fifth year. In this situation, if the forfeiture were enforced according to its terms, the buyer would lose the following amounts:

- Down payment ........................................ $10,000
- Five annual $3,000 installments .................. $15,000
- Improvements made .................................. $10,000
- Total ................................................. $35,000
The seller would have lost the following:

- Rental income on farm for five years .................. $7,500
- Recoverable damages .................................. $5,000

Total .................................................. $12,500

Amount of penalty to buyer ............................ $22,500

In this example, the courts would not enforce the penalty clause, and it would be necessary for the seller to foreclose and have the property sold.

If the buyer defaults and a forfeiture occurs, it is doubtful whether the buyer can be reimbursed for the value of any improvements that he may have placed on the land. However, the parties may provide in the contract for payment for improvements if the buyer defaults. The buyer may also secure some degree of protection if the contract calls for delivery of a deed to the buyer and a mortgage to the seller upon completion of a certain portion of the payments. Should the buyer then default, he has all the rights of a mortgagor to have a sale through foreclosure.

Whether the seller has completely complied with the terms of the contract in declaring the forfeiture. The seller must comply strictly with the contract provisions before he can declare a forfeiture, since the Illinois courts look with general disfavor upon forfeitures.

**Seller in default**

If the seller refuses to deliver the title to the buyer at the time called for in the contract, the latter can obtain assistance from the courts in forcing delivery of the title.

If it is discovered that the seller’s title is defective and that he has nothing worth conveying, the buyer’s only remedy is an action for damages for breach of the contract. Before signing the contract, the buyer should always check to see that the seller has good title to the property.

**Important Contract Clauses**

**Prepayment privilege**

It appears to be the law in Illinois that without a prepayment clause in the contract, any attempt by the buyer to make payments of principal to the seller before they are due may be rightfully refused by the seller — even if the full amount of interest is also tendered.

In years when farm income is high, the buyer may desire to pay ahead as a hedge against years when income may be low. If the seller agrees to this privilege, a special provision in the contract should give
the buyer the right to prepay installments of principal that the buyer may apply against future installments. However, the usual agreement limits the number of future installments that may be paid at any one time and requires that these payments be in multiples of the regular payment. The provision should also state whether the installment is to be paid with interest, and if so, the amount of interest.

The seller needs a restriction on prepayments in the first year to protect his right to be taxed on an installment basis. Most sellers will have tax savings if the amount received in the year of sale does not exceed 30 percent of the total purchase price. For this reason, the buyer should not be allowed to make prepayments in that year that will bring the amount paid on principal above 30 percent.

**Grace period**

The usual period of grace in which to make overdue payments is 30 to 60 days. It is suggested that this period might be increased as the purchaser's equity increases. For example, a 60-day grace period might be allowed the buyer until 20 percent of the total purchase price has been paid, a 90-day grace period between 20 percent and 40 percent, 120 days between 40 percent and 60 percent, and so on.

A long grace period will, of course, delay the seller's right to declare a forfeiture. In addition, the seller may be dependent on the payments as annuity income to meet living expenses. It seems fair, however, to allow the buyer additional time to meet payments as his equity of ownership increases.

**Mortgage provision**

Many contracts provide that upon payment of a certain portion of the purchase price, the buyer is entitled to receive a deed if he, in turn, executes a mortgage to the seller. This provision entitles the buyer to fuller protection upon default. Such clauses often state that upon payment of 50 percent of the total price, a deed and mortgage shall be executed.

**Arbitration clause**

An agreement to arbitrate future disputes is enforceable in Illinois even if one party declines to use arbitration. An arbitration clause is valuable because both parties are usually anxious to avoid the costs and consumption of time incident to litigation. The decision of the arbitrators is binding under Illinois law.
Federal Taxes

Income tax considerations

If the seller receives less than 30 percent of the total sale price in the year of sale, he may qualify for certain tax advantages. He may prorate his profit over the life of the contract. For example, if the total contract price is $80,000, the original cost of the farm to the seller was $20,000, and the contract calls for a down payment of $24,000, the computation is as follows:

\[
\frac{\$60,000 \text{ (total profit)}}{\$80,000 \text{ (contract price)}} \times \$24,000 \text{ (down payment)} = \$18,000
\]

(profit reported in first year)

The remaining $6,000 of the down payment represents a return of capital on which there is no tax.

If the land were held for more than six months, the gain would be long-term capital gain, and only half of the $18,000—or $9,000—would be subject to tax.

Payment in the year of sale does not include notes or other evidences of the purchaser's indebtedness, nor does it include amounts paid as interest on the debt.

If more than 30 percent of the sales price is received in the year of sale, the seller is usually taxed as if he had received the entire proceeds in the year of sale.

As noted earlier, the use of a revisable-payment plan or a product-payment plan imparts flexibility to the installment land contract. However, the use of either plan involves the following problems for the seller in reporting income over the life of the contract.

1. Although less than 30 percent of the total sales price may originally have been paid in the year of sale, a subsequent slump in land values and a revision of installments in accordance with this slump, might have the ultimate effect of showing payment of more than 30 percent in the year of sale. One way to prevent this contingency is to provide that the total purchase price not be less than a certain stated amount.

2. The use of these options would make it difficult to determine what percentage of each portion of the purchase price received is a nontaxable return of capital. A possible solution is to pay no tax on payments until the entire cost is returned. However, proceeds over and above cost are then fully taxable. It is suggested that an attorney be consulted before using this method.
Interest

Since July 1, 1963, installment contracts for sales in excess of $3,000 must provide for an interest rate of at least 4 percent to avoid reporting "imputed" interest at a rate higher than 4 percent. Any "imputed" interest is ordinary income to the seller and a deduction for the buyer.

Estate- and gift-tax considerations

A flat $60,000 exemption is allowed for the estate of a deceased person. Included in "gross estate" is the value, at time of death, of all property, both real and personal. This includes the contract interest of the seller, which passes as personal property.

A land contract is sometimes used to reduce the seller's estate. Each taxpayer is allowed a $30,000 lifetime exemption plus an exemption of $3,000 for each recipient of a gift. By giving installment payments to heirs, the seller can reduce his estate by the amount of the gift.

The seller may solve the estate-tax problem by giving the entire contract to an heir or heirs, but income-tax problems may then arise. The tax code provides that if an installment obligation is disposed of by gift, income tax is still due on any gain or loss. This rule would apply even if a gift were made of the entire installment contract. In this situation, the donor's income tax is computed just as if the installments disposed of had been paid when due. However, capital-gain treatment is allowed.

If the seller dies, his estate, or the person who inherits the contract, reports the income from collections in the same manner as the decedent would have been required to report it.

Practical Aspects of Using Installment Land Contracts

Written contract required

Although all the terms and conditions of the agreement between the parties will undoubtedly be reduced to writing in the well-thought-out transaction, the law requires a writing for the agreement to be enforceable. All oral agreements made prior to the execution are not enforceable unless they have been written into the contract. However, oral agreements made after the execution of the contract are valid and enforceable. For example, when the seller agrees with the buyer to accept payment on a later date than that called for in the contract, he cannot then treat the buyer as in default when following payments are not made on the date stated in the written contract.

It is a common practice to use printed form contracts for the agreement. Although such form agreements may be suitable in some cases,
they are not completely suitable in all situations, and it is strongly urged that a special contract be drafted that contains a clear and concise statement of the actual agreement.

**Representation by counsel**

Each party will want to consult an attorney for the purpose of drafting the contract. The attorney will make sure that the best interests of his client are protected by appropriate provisions in the contract. It is best for each party to be represented by his own attorney in the negotiation of the contract.

Often, however, one attorney represents both parties in the negotiation and drafting of the contract. This practice is acceptable if the attorney makes it clear to the parties that he is representing conflicting interests.

**Escrow provisions**

As a general rule, no installment-land-contract transaction should be attempted without the aid of an escrow agent. A neutral third party such as a bank or trust company usually serves as the agent, holding the documents for the parties while the contract is being performed. The following illustration shows how an escrow provision helps to simplify such a transaction and how it protects the rights of the parties.

Assume that the seller has contracted to sell his farm to the buyer for $55,000 — $5,000 down and $2,500 per year for 20 years. The parties have further agreed that after $25,000 of the purchase price has been paid (at the end of the eighth year), the seller is to give the buyer a warranty deed and the buyer is to give the seller a mortgage to secure the balance due. The contract contains a clause allowing the seller to declare the buyer’s rights forfeited if the buyer defaults in payment before receiving the deed.

The escrow provision for the above transaction would provide that on the date of the contract the seller should deposit with the escrow agent his properly executed warranty deed to the farm. The buyer, on the other hand, would be required to deposit his properly executed note and mortgage to the seller. An executed copy of the contract would also be presented to the escrow agent. If the contract is to be recorded by the buyer, a quit-claim deed from the buyer should be placed in escrow so that the seller will have a clear title in the event of a forfeiture.

During the term of the contract, the buyer will make his annual payments to the escrow agent, who will dispose of them as directed by the seller. After eight annual payments have been made, the escrow
agent will deliver the seller's warranty deed to the buyer and the buyer's mortgage to the seller. If the buyer should default during the 8-year period, the escrow agent will deliver the quit-claim deed to the seller.

Thus, when the contract contains an escrow provision, each party is assured that he will receive the document to which he is entitled at the proper time. The buyer knows that he will receive his deed at the proper time if he continues to make his payments, even if the seller should die during the 8-year period. The seller, on the other hand, knows that he will get the mortgage to which he is entitled at the same time that the buyer receives the deed. If the seller should marry during the 8-year period, his wife would have no dower rights in the farm, since the seller had executed the deed before his marriage.

This escrow agreement should be incorporated into the contract, and three copies made of the contract—one for the buyer, one for the seller, and one for the escrow agent.

**Merchantability of title**

Often the seller merely agrees to furnish a merchantable abstract of title sometime before final payment by the buyer. For greater protection to the buyer who is making a substantial investment of time and money, it is suggested that the seller's abstract of title be brought up to date and submitted for examination and approval by the buyer's attorney before the down payment is released to the seller. In lieu of an abstract, a title-guarantee policy may be used.

**Time and place of payment**

The time and place of payment should be set forth in the contract. It is recommended that the payments be made to an escrow agent. The agent can then determine when the duty to deliver the deed or other document arises.

**Interest provisions**

The annual installments of principal and annual interest on the unpaid balance can be treated as two separate items in the contract or as one payment on an amortized basis.

In addition to interest on the unpaid balance, provisions for interest on delinquent installments and on expenditures made by the seller for the buyer, such as insurance premiums, taxes, and repair bills, may be included. The seller may desire that the interest rates on delinquent installments and expenditures be higher than the interest on the unpaid balance. See page 16 for the Internal Revenue Code interest requirement.
Signatures

When the contract is in final form, it should be signed by all parties. Although the wife of a seller cannot be compelled to sign the contract, it is desirable that she do so, especially if no deed is placed in escrow at that time. The same rule applies to the husband when the wife is the seller.

If the buyer and his wife are to take title as joint tenants or as tenants in common, then the buyer’s wife should also sign the contract. Unless the contract is to be recorded, it is not necessary for it to be witnessed or signed before a notary public.

Recording

Many installment land contracts are recorded, although it is not legally necessary to do so. When the buyer does not take immediate possession, recording serves a useful purpose by protecting him from third parties that could take good title against his interest.

Conclusions

Installment land contracts have worked out very well in a period of rising land values and fairly high farm income. They may not work out so well if there should be a long term of low farm income and decreasing land values.

Safety for the buyer is increased by a substantial down payment, by a long-term contract to keep installments in line with earning capacity and a satisfactory standard of living, and by incorporating into the contract many of the provisions described in this circular. A fair and complete contract also gives the seller greater assurance that installments and interest payments will be made, and prevents disputes that might arise in the absence of a detailed contract.

Appendix

The following sample contract form should give those about to enter into an installment land contract and, possibly, their attorneys some ideas about what the contract should contain. It is not meant to be an exact model of the contract that the parties will want drafted by their attorneys.

INSTALLMENT LAND CONTRACT

This agreement is made this _______ day of ____________, 19____, between the seller, ______________________, and the buyer, ______________________.
1. Description of premises. The seller agrees to sell and the buyer to buy the following described real estate with all improvements thereon: (the full legal description would be inserted here).

2. Price and terms. The total purchase price is $__________ to be paid as follows:

$__________ paid concurrently with the execution of this contract, the receipt of which the seller hereby acknowledges.

__________ annual installments of $__________ each, which, together with accrued interest, shall be paid on the _________ day of _________ of each year, commencing on _________, 19_________, and ending _________, 19_________.

Whenever $__________ of the principal sum has been paid, the warranty deed shall be released in exchange for a note and mortgage. The balance of the purchase price, $__________, is to be paid in accordance with the terms of a note and mortgage agreement executed concurrently with the execution of this contract.

Interest on principal shall be computed at the rate of _______ percent per annum on the unpaid balance.

All payments called for under this contract are to be paid at the Bank in _________, Illinois, to be deposited to the account of the seller.

(See footnote 4 for optional payment provisions.)

1Contracts frequently provide that annual installments be broken down into two or more payments during the year.

2If it is desired to keep payments at the same level throughout the contract, the parties may provide for lower principal payments at the beginning, the payments gradually increasing as interest becomes less. Attorneys can provide schedules that show how much of each payment is credited to principal and how much to interest, and will draft the appropriate provision in lieu of the one shown here.

3This paragraph to be used when the buyer anticipates paying off the balance of the purchase price by a mortgage to the seller.

4For long-term contracts, the parties may wish to provide for one or more of the following optional provisions:

Revisable payment plan. The total price for the premises, not to exceed a total of $__________, shall vary as the average price per acre of farm real estate in Illinois changes, in accordance with the following rules: (herein will be inserted detailed provisions for adjusting the amount of payments in accordance with the fluctuation in land values).

Product payment plan. $__________ of the yearly payments shall be in cash. The remainder of each and every payment may consist of _________ bushels of _________ (corn, soybeans, wheat, etc., or a combination) or the cash equivalent of the amount of the product due. Any payment wherein the above-specified option to pay in products or their cash equivalent is exercised, shall have the same force and effect as if the cash-installment payment called for in section 2 of the contract had been paid.

Revisable interest rate. The interest rate shall remain as specified in section 2 of this contract, except for such changes as may be made effective because of subsequent changes in the average interest rate on first mortgages of farmland in Illinois, to be determined as follows: (herein will be inserted provisions designed to effectuate the goals of the parties in using this option).
3. Possession of the premises. The buyer is entitled to exclusive possession of the above-described premises during the life of the contract. The buyer’s right to possession shall terminate in the event of his default in any of the terms of this contract sufficient to entitle the seller to consider the contract terminated and to retake possession of the premises.

The seller shall deliver possession of the said premises to the buyer on or before __________________ , 19_____.

4. Escrow provisions. The _________________ Bank of _________________ is appointed escrow agent for the buyer and the seller, and the original signed copy of the contract shall be deposited with said escrow agent. Concurrently with the execution of this contract, the seller shall deliver to the said escrow agent a good and sufficient warranty deed of the premises, to be delivered to the buyer upon the payment of all installments of principal and interest and all other debts and charges provided for under this contract.

The seller shall furnish an abstract of title, brought down to date, on or before ______________ , 19_____, showing title in seller, and shall allow the buyer a reasonable time to have the abstract examined and to notify the seller of any objections. If title is found defective, the seller shall have a reasonable time to put same in merchantable condition. The seller shall then deliver to the escrow agent, the abstract of title of said premises (or a title insurance policy in the amount of the contract price), showing merchantable title in fee simple in the seller.

The buyer shall deliver to the escrow agent a mortgage of the premises to secure a note in the amount of $__________________ as the balance of the purchase price, said note and mortgage to be delivered to the seller upon completion of payment of installments as provided in section 2 above. Escrow charges shall be paid by ______________ , 19_____.

5. Right to prepayment. At the regular time set for annual payment of installments and interest after the first year, the buyer shall be entitled to pay future annual installments of principal not to exceed two such future installments in any year.

At the time of payment of a future installment, interest on such installment shall also be paid at ______ percent.

The buyer shall not be deemed to have defaulted in any payments of installments as long as the total of all such payments, including prepayments, made at the time a default is alleged is equal to the number of payments that have fallen due up through the time of the alleged default.

1 In some cases a title insurance policy will be used in lieu of an abstract.
2 This paragraph to be inserted in the contract only when the balance of the purchase price is paid in accordance with the terms of note and mortgage.
3 Optional paragraph. Prepayments may increase the income tax of the seller and he may have some expense in reinvesting such proceeds. Therefore, it seems fair that the buyer pay some interest on prepayments, although it may be smaller than the regular interest rate.
6. Grace periods. If the buyer is in default as to any portion of an installment due and payable, or any portion of the accrued interest due and payable, he shall be allowed a grace period to make payment starting with the first day after such default, according to the following schedule:

If the buyer has paid less than 20 percent of the purchase price plus accrued interest, there shall be 60 days’ grace.

If the buyer has paid 20 to 40 percent of the purchase price plus accrued interest, there shall be 90 days’ grace.

If the buyer has paid over 40 percent of the purchase price plus accrued interest, there shall be 120 days’ grace.

Overdue installments of principal and accrued interest shall bear interest at the rate of 7 percent per annum. To prevent default, it shall be necessary to pay within the applicable grace period the accrued interest and overdue installments of principal and regular accrued interest.

Immediately upon the expiration of the applicable grace period, if the buyer has not made full and complete payment of all installments of principal and interest then owing, the buyer shall, at the option of the seller, forfeit all his right and interest in the premises and the seller shall have the immediate right to re-enter and take possession of said premises.

7. Right to assign and to mortgage. In the event the buyer wishes to sell or assign his interest during the life of this contract, the seller shall have the first option to repurchase the above-described premises from the buyer at the contract price plus the appraised market value of improvements made with the consent of the seller.1

Furthermore, during the life of this contract, the buyer shall, before mortgaging his interest, secure the written consent of the seller.2

8. Taxes and assessments. Real property taxes for the year 19__ shall be paid by the ______________. All other taxes and assessments levied on the premises subsequent to the date of execution of this contract, and any unpaid installments of special taxes or assessments not yet due for improvements completed at the date of this contract, shall be paid by the buyer.

9. Insurance. The buyer agrees to pay to the seller the unearned portion of prepaid premiums on insurance now in force on improvements on said premises with possession date.

1 This clause is frequently desired in family transactions when the parents want protection against the son or daughter, or their heirs, transferring the farm out of the family.

2 If no option to repurchase is used, written consent to sell or assign is usually required.
It shall be the duty of the buyer to keep all improvements insured by reputable companies during the life of this contract, and such insurance shall be kept sufficient to cover the full insurable value of the improvements. The insurance shall be made payable to both the seller and buyer, and the policy shall contain an endorsement to this effect.¹

A copy of each policy shall be placed in escrow with the escrow agent or submitted to the seller for his inspection.

10. **Farm management.** The buyer agrees to farm said premises in accordance with sound farming practices and to keep the premises in good repair at the buyer’s expense.

The buyer agrees that the seller and his authorized representatives and agents shall have access to said premises at all reasonable times for the purpose of examining the condition of said premises.

The buyer agrees not to do any substantial remodeling work or new construction on said premises without the seller’s prior written approval.²

11. **Mineral deposits.** If income is realized as a result of leasing for or development of oil, gas, or any valuable mineral deposit while this contract is in force, the net return, after deduction of necessary and ordinary expenses, shall be paid in equal shares to the seller and the buyer for a period of ___________ years, or for the length of the production period, whichever time is shorter.³

12. **Advancements.** If the buyer fails to insure improvements or to pay taxes or other charges or assessments as provided above, then the seller, may, but is not obligated to, procure such insurance, pay such taxes, discharge or purchase any tax lien accruing by virtue thereof, or any title or mechanic’s lien affecting such real estate that accrued by virtue of acts done or permitted to be done by the buyer or by any party claiming or holding under the buyer. The buyer shall repay all money so paid immediately upon demand together with interest thereon at the rate of 7 percent per annum from the time of such payment.

13. **Arbitration.** If any dispute, difference, or question shall at any time hereafter arise between the parties under this contract, or their respective representatives, heirs, administrators, executors, or assigns, concerning anything contained herein or as to the rights, liabilities, or duties of the said parties hereunder, the same shall be referred to three arbitrators chosen as follows:

¹ The parties can provide that insurance proceeds for loss of improvements may, at the option of the buyer, be applied to the purchase price. Consider carefully, however, the effect of such a clause on federal income taxes payable by the seller. If the loss occurred during the year of sale and the proceeds are applied to the purchase price, the 30-percent maximum may be exceeded.

² The purpose of this provision is to give the seller some protection against liens for the value of improvements.

³ This section may be desired in family transactions.
One person is to be chosen by the seller and another chosen by the buyer. These two persons shall select a third person, and the three shall pass on the issue at hand.

The arbitrators shall submit a report in writing to the seller and the buyer. The report shall be given within 30 days from the time the arbitrators are chosen, and the report shall be binding on both the seller and buyer and on their heirs, executors, administrators, and assigns.

The expense of arbitration shall be borne equally by the parties.

14. Default and forfeiture. If the buyer fails to make payment of all moneys specified to be paid by him under this contract and within the time for payment allowed under the contract, or to keep the improvements on said premises in good repair, this agreement shall, at the option of the seller, be forfeited and determined. The buyer shall forfeit all payments made by him under this agreement, and such payments shall be retained by the seller in full satisfaction and in liquidation of all damages sustained by the seller, and the seller shall have the right to re-enter and take possession of said premises.

It is mutually agreed that all agreements herein contained in this contract shall extend to and be binding upon the heirs, executors, administrators, and assigns of the respective parties.

In witness whereof, this land contract has been executed and delivered this day of __________, 19_____.

__________________________ (seal)
Seller

__________________________ (seal)
Seller

__________________________ (seal)
Buyer

__________________________ (seal)
Buyer

1 The parties could provide that there be some reimbursement for improvements made by the buyer with consent of the seller. In most cases, however, it would be better to amend this contract or enter into a separate contract for reimbursement at the time the improvement is planned.