

**LAND INSTALLMENT CONTRACTS:  
LEGISLATIVE SWING IN SELLER'S FAVOR IS A  
NECESSITY IN TODAY'S DECLINING HOUSING MARKET**

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**ABSTRACT:**

In today's sluggish, but bargain filled real estate market, purchasers unable to qualify for conventional bank financing, may still be able to acquire their dream homes if seller financing, in the form of land installment contracts, is available.<sup>1</sup> This alternative financing scenario affords a less than credit worthy purchaser with the means necessary to become a homeowner. At settlement, the purchaser takes possession of the property, while the seller retains actual legal title. During the contract term, purchaser makes installment payments to the seller until the contract price has been paid in full. In the event of purchaser's default, the purchaser forfeits all sums paid under the contract, as well as the property. Due to the often harsh consequences of a default under a land installment contract, many states have enacted statutes eliminating property forfeiture as an available remedy. In addition, many courts of equity have either refused to enforce forfeiture provisions, or have severely limited their use in land installment contracts. This pro-purchaser intervention by legislatures and judges across the United States has created uncertainty as to the enforceability of forfeiture provisions, thereby resulting in a disincentive for sellers to extend this form of financing to needy purchasers.

**INTRODUCTION:**

This Article will examine the shift in the United States from strict enforceability of forfeiture provisions in land installment contracts, to the imposition of procedural requirements prior to forfeiture, and even the total elimination of forfeiture as a remedy. It

will then address the impact such sweeping change has had on the viability of the land installment contract. Finally, the authors propose the reversal of paternalistic protections afforded purchasers, in favor of extending a protection to sellers in the form of strict enforcement of forfeiture provisions, or the guaranteed application of all contract remedies available at law or equity. A return to the favorable treatment of land installment contracts is an economic necessity in today's tenuous real estate market.

#### **I. LAND INSTALLMENT CONTRACT: AN ATTRACTIVE ALTERNATIVE TO CONVENTIONAL FINANCING.**

In the United States, the three primary financing transactions employed to secure a loan for real property are the mortgage; the deed of trust; and the land installment contract.<sup>2</sup> While all three forms of financing enable a purchaser to borrow money to finance his acquisition of real property, the decision to choose one particular method over another is often dependent upon the remedies available to seller in the event of purchaser's default.

The most frequently used forms of conventional financing are the mortgage and the deed of trust. The mortgage is an instrument recorded among the land records as security for a promissory note given by purchaser.<sup>3</sup> A conventional mortgage is a device used by a purchaser desiring to buy property by transferring to the bank or lender a lien or defeasible legal title in exchange for the price, or a portion of the price of the property. Usually, the purchaser provides seller with an initial down payment and a note. In return, seller delivers to purchaser the deed to the property. In the event of purchaser's default, the seller must seek judicial intervention by suing on the note, or foreclosing on the mortgage. The second financing method, the deed of trust,<sup>4</sup> is an instrument which takes the place of a mortgage, and legal title is granted to one or more trustees as security for repayment of the debt. The

deed of trust is more favorable to lenders because it provides a third party trustee with a power of sale, and does not require judicial foreclosure.

While the aforementioned conventional financing methods would certainly be preferred by a seller, such third-party financing is not always available to credit challenged purchasers. Where a seller has no other choice than to offer his own financing of the purchase price via a land installment contract, the seller must be afforded some benefit for the undertaking of additional risk. Due to the likelihood that a distressed purchaser would be unable to supply a large down payment, the seller must be in a position to quickly realize his security upon default, and the standard forfeiture provision found in land installment contracts is the most efficient means of accomplishing such realization.

Like conventional financing methods, land installment contracts obligate the purchaser to make installment payments of principal and interest to the seller, pay taxes and insurance on the property, as well as repair and maintain the property. Unlike third party financing, land installment contracts do not typically subject purchasers to substantial transactional costs. The seller offered financing obviates the necessity to incur costs associated with title insurance, property appraisals, credit reports, recordation costs and the like.<sup>5</sup> Unlike a third party lender, the seller has first hand knowledge of the property securing payment of the debt; therefore, the lending seller has no real need to incur title related costs. Unfortunately for the unsuspecting purchasers, without the benefit of a third party lender insisting that purchaser obtain title insurance, the purchaser may not discover that the property is encumbered. Since the purchaser of a land installment contract does not acquire title until all contract sums have been paid to seller, the initial concern for the marketability of title is postponed until the time of title transfer, which for some purchasers

may be too late. Some jurisdictions have attempted to protect purchasers and diminish the possibility of title issues by requiring the seller to warrant marketable title.<sup>6</sup> The state of Maine requires sellers to disclose the existence of encumbrances,<sup>7</sup> while Maryland has restricted the placing or holding of a mortgage on the property that exceeds the balance due under the land installment contract.<sup>8</sup>

Land installment contracts are favored by purchasers, because they provide a lower cost method of financing for the low-income purchaser, by allowing for low down payments and requiring few closing costs. While the seller might prefer to receive cash at settlement, or the security afforded by third party financing, the land installment contract offers seller a non-judicial means of quickly recovering the property after a purchaser's default. The land installment contract enables purchasers to buy property when they could not do so under other financing methods, and it provides sellers with a larger pool of possible purchasers.

## **II. STATUTORY AND JUDICIAL LIMITATIONS ON FORFEITURE.**

Historically, the land installment contract was viewed as a positive alternative form of financing and its forfeiture provision was favorably enforced. Courts sought to uphold the parties' rights to freely enter into contracts and preserve the intentions of the parties to be bound by the contract terms, despite their apparent harshness.<sup>9</sup> The theory behind enforcement could be based on the notion that the purchaser had no legal right to the property since title was held by the seller, and the only interests that were being forfeited were purchaser's contractual rights. In an attempt to lessen the severity of the forfeiture provision, states have enacted protective legislation aimed at short circuiting the forfeiture remedy. A majority of state statutes impose a "grace period" during which time the

purchaser can pay its contract arrearages and avoid property forfeiture.<sup>10</sup> In these states, a forfeiture is allowed provided that the seller has notified the purchaser and other parties of interest, and waits the prescribed time period in which the purchaser may cure the default. Some states determine the length of the grace period based upon the percentage of the contract price paid prior to default.<sup>11</sup> In Ohio, if the property has been improved with a residential dwelling, the property must be judicially foreclosed, unless the contract has been in effect for less than 5 years, or less than 20% of the principal amount of the contract has been paid.<sup>12</sup> The most far reaching statute belongs to the state of Oklahoma, which eliminates forfeiture by requiring that land installment contracts be subject to the same requirements of foreclosure as a mortgage.<sup>13</sup>

Judicial limitations of forfeiture have occurred because courts have shown a propensity to assist a defaulting purchaser often viewed as less sophisticated in the world of finance, than its more business savvy counterpart, the seller. Where states have failed to step to the plate and afford statutory relief, their judiciary has assisted the defaulting purchaser by limiting the effect of forfeiture or totally avoiding it. In the case of Petersen v. Hartell, 707 P. 2d 232 (Cal. 1985), the seller was the grandmother of the purchaser of a six acre parcel of land. The agreement required the granddaughter to pay a purchase price of \$9,000, payable in monthly payments of \$50. After missing several payments, the granddaughter stopped paying any installments for a period of several years, and then sent \$250 to her grandmother's attorney. The check was returned with a note stating that the seller was exercising her right to terminate the contract. The purchaser turned around and sued for specific performance and paid the balance due. The California Supreme Court held that where the seller of the land retains title as security for amounts payable under an

installment contract, the purchaser “had an unconditional right to a reasonable opportunity to complete the purchase.”<sup>14</sup> Despite the granddaughter’s willful default on several payments, the court found that because the purchaser had paid a substantial portion of the contract price, she retained an absolute right of redemption, by paying the balance due. This right of redemption was also afforded to a defaulting purchaser in South Carolina, where the Supreme Court held that a court of equity could hold that the purchaser’s right of redemption was superior to the seller’s right to strict forfeiture.<sup>15</sup>

One of the other techniques employed by courts in limiting the effects of forfeiture is the award of restitution. The purchaser’s payments to seller that exceed seller’s actual damages are returned to the purchaser. Damages are deemed to include seller’s loss of the bargain of his contract or the fair market rental value of the property while purchaser was in possession, as well as cost of repair.<sup>16</sup> In California, courts apply a choice of two formulas when determining seller’s damages. The first is referred to as the “rental value” and the seller must return to purchaser any sums that exceed the fair rental value of the property during purchaser’s possession. The second option is the “difference value” in which the purchaser receives the amount by which purchaser’s payments exceed the difference between the current market value and the higher contract price.<sup>17</sup> In today’s market, the seller would most likely opt for the difference value calculation due to the current drop in property values. This phenomenon has not been witnessed in the United States since the end of the 1980’s and early 1990’s.

Where courts have recognized an equity of redemption in the purchaser, the question arises as to what happens when the purchaser is unable, or is not desirous of redeeming the property? Indiana courts have considered these factors when determining

whether forfeiture should be allowed. In the case of Skendzel v. Marshall<sup>18</sup>, a defaulting purchaser paid \$21,000 out of the \$36,000 contract price. The court ordered that the land installment contract had to be foreclosed in accordance with mortgage law procedures. In light of the purchaser's substantial payment of the purchase price, the court found that seller's title retention amounted to a reservation of a lien or a mortgage. Of particular interest, is the court's retention of forfeiture as a remedy in certain factual circumstances. According to the Skendzel court, in cases where the purchaser has abandoned the property, or retains possession after default having only paid a minimal amount of the contract price, forfeiture remains an available remedy to the seller.<sup>19</sup>

The last form of judicial intervention to be addressed herein is the total disregard of the land installment contract as an independent form of financing, or at a minimum, an enforceable contract. In the Kentucky case of Sebastian v. Floyd, 585 S.W. 2d 381 (Ky. 1979), the purchaser agreed to buy seller's house, and both parties signed a land installment contract. The contract's forfeiture clause provided that if purchaser failed to make monthly payments and remained in default for sixty (60) days, the seller could terminate the contract and retain all payments as rent and liquidated damages.<sup>20</sup> During the first twenty-one (21) months of the contract, the purchaser missed seven (7) installment payments and the seller sued for the money owed, plus repayment of taxes and insurance. In addition, the seller sought to have the forfeiture clause enforced. The court held that when an installment land contract is used as a means of financing the purchase of property, the seller's interest constitutes a lien on the property which secures payment, in other words, a mortgage. Furthermore, the court specifically held that the seller under a land installment contract is not entitled to enforce a forfeiture clause, rather the proper remedy for the seller is to seek

judicial sale of the property in the event of purchaser's default. Unlike Indiana courts, which have limited the application of forfeiture to specific fact patterns, Kentucky courts have completely eliminated the forfeiture remedy by treating all land installment contracts as mortgages.

### **III. PROTECTION OF SELLER'S INTEREST VIA NON-FORFEITURE REMEDIES**

As evidenced above, the original land installment contract has been statutorily and judicially altered to favor the defaulting purchaser. Due to the disparate treatment of this financing method by states and their judiciary, the seller is often unable to determine which remedy is available and most importantly, which will provide him with a favorable result upon purchaser's default. In today's home real estate market, prices are dropping by the hour and a seller faced with a defaulting purchaser may not be well served by seeking to enforce a land installment contract forfeiture clause. Upon forfeiture, the seller will regain possession of his property; however, that property is now worth less than the contract price. If the seller happens to live in a jurisdiction like Oklahoma or Kentucky<sup>21</sup>, pursuit of forfeiture is not an option, and the seller must comply with the foreclosure procedures applicable to mortgages. By not allowing forfeiture, the seller must seek judicial aid and foreclose on the property. At the public sale, if the proceeds received by seller are less than the amount he is owed under the contract, the seller could sue the purchaser for the deficiency, and execute on the judgment. For once, a seller in Kentucky or Oklahoma will end up with the most favorable result, in spite of the court and legislatures intervention. Unfortunately, as evidenced by our earlier examination of state case and statutory law, the seller can't always count on the same results being applied by the courts. At times there

appears to be a trend toward treatment of all land installment contracts as mortgages, and then again, depending on how the wind blows, a combination of contract and mortgage law elements will apparently govern.

Despite the judiciaries' inconsistent treatment of available seller remedies, the seller is not in as precarious a position as it may seem. In today's climate, seller is best served by pursuing specific enforcement of the land installment contract. It is often common for a seller to find himself faced with a purchaser who has not made many installment payments, and the value of the property is worth far less than the contract price. In this scenario, the purchaser has either abandoned the property, or has voluntarily stopped making payments to the seller, in order to cut his losses. Rather than seeking to enforce the right of forfeiture, the seller should pursue specific enforcement of the contract. The one impediment facing the seller when seeking specific performance is that there is no acceleration clause in a land installment contract.<sup>22</sup> Therefore, if seller were to deliver the title to the property, he would only be entitled to receive the payments then due, and not the remaining contract price. Fortunately, some courts have applied their equity powers to accelerate the remaining balance due, even in the absence of an acceleration clause<sup>23</sup>.

In Barnett v. Oliver, 858 P.2d 1228 (1993), the purchasers, Matthew and Erma Hamill, contracted to buy a property from the sellers, Vernon and Mildred Barnett for \$65,000, in October of 1985. After paying a deposit at settlement, the Hamills owed the sellers \$58,500. plus 10% interest on a land installment contract. The Hamills made 64 installment payments to the sellers during the following six years, but in April of 1991, the Hamills notified the Barnetts of their intention to return the property effective May, 1991. The sellers brought an action to foreclose, which the trial court granted. The property was

sold at a foreclosure sale and purchased by the sellers for \$24,000. The Hamills appealed contending that the trial court erred by entering judgment against them for the entire balance due under the contract. The Hamills argued that the court was not authorized to accelerate the balance due in the absence of an acceleration clause. Citing the holding in the Michigan case of Carpenter v. Smith, the Kansas Appellate Court applied the doctrine of anticipatory repudiation in order to accelerate the balance due. The Hamills anticipatorily breached the installment contract when they notified the Barnetts that they were returning the property. “While the law abhors forfeitures, it does not abhor the fulfilling of contracts voluntarily made in which parties have bound themselves to perform certain definite requirements.”<sup>24</sup> In favoring judicial economy, the Appellate Court accelerated the balance due and held that the sellers were entitled to receive the amount promised to them under the contract. Without such equitable relief, the sellers would have had to repeatedly sue the purchasers each time the installment payments were past due.

Other states which have used equitable powers to accelerate the balance due under land installment contracts include Wisconsin, Washington and Ohio.<sup>25</sup> “Under the doctrine of anticipatory repudiation, the vendor need not wait for a future payment to become due if the purchaser has clearly indicated an intent not to perform in the future. In the installment land contract context, courts seem to apply this doctrine with little hesitation. Thus, the absence of an acceleration clause hinders the vendor only by allowing the purchaser to reinstate the contract before the forfeiture actually takes place.”<sup>26</sup>

The topic of limiting damages was briefly addressed in Section II, as a means by which courts could limit the impact of forfeiture. The remainder of this Section will focus

on the seller's cause of action for damages in lieu of enforcement of forfeiture. In the Colorado case of Steinhoff v. Fisch,<sup>27</sup> the seller brought an action for damages, to recover the balance of the purchaser price due under the Contract. The trial court held that the seller was limited to the exclusive remedy of forfeiture under the terms of the pre-printed land installment contract. The Court of Appeals overruled stating that the forfeiture and liquidated damages provisions of the contract were not mandatory and seller was not prohibited from suing for damages in the amount of the balance of the purchase price.

The ability of a seller to choose his remedy under a land installment contract is not as clear cut in all jurisdictions as it is in Colorado. In Metropolitan Mortg. & Securities Co., Inc. v. Belgrade, 816 P.2d 868 (Wyo.1991), the Supreme Court of Wyoming determined that an issue of material fact existed as to whether the parties intended their agreement for warranty deed (aka land installment contract) to be a unilateral or a bilateral contract. If the parties intended the contract to be unilateral, then the only remedy available to the seller upon purchaser's default was forfeiture. The trial court determined that a land installment contract was unilateral, as it was an offer by seller that could only be accepted by the purchaser upon paying the installments required under the contract. Historically, Wyoming courts held that under a land installment contract, the seller is able to enforce a forfeiture provision, but is not entitled to a deficiency.<sup>28</sup> Upon review, the Wyoming Supreme Court in the instant case, posed the question whether a land installment contract is really a unilateral contract, and therefore limited to the forfeiture remedy. If it is unilateral, only the seller has a duty to deliver the deed to purchaser upon receipt of all installment payments, but surprisingly, there is no obligation upon the purchaser to make those payments. If, on the other hand, the contract is deemed to be bilateral, then all remedies at

law and equity would be available to the seller. The language of the land installment contract in Metropolitan Mortg., appears to provide seller with an option to either declare the agreement null and void, or enforce the contract upon purchaser's default. Finding that the language of the contract was ambiguous, the Supreme Court remanded the case to the trial court to determine whether the parties intended the installment contract to be a unilateral or a bilateral agreement.

Lastly, foreclosure as a non-forfeiture remedy available to seller, has already been examined in Section II. As evidenced throughout this article, statutory and judicial trends have been leaning in favor of treating land installment contracts as mortgages. While this treatment benefits the purchaser when housing markets climb, it creates a burden for the seller in today's real estate market, which is wrought with declining home prices. While specific performance, action for damages, and foreclosure are recognized contract remedies, as evidenced by the cases discussed herein, when dealing with land installment contracts, the availability of such remedies is far from guaranteed.

#### **IV. CONCLUSION.**

Due to varying treatment of land installment contracts by the judiciary and the various state legislatures, a return to strict enforceability would allow the parties to realize the benefit of their contractual bargains, as well as achieve a more uniform treatment of remedies throughout the jurisdictions. The uncertainty of whether a seller's land installment contract forfeiture clause would be enforced, outweighs the benefit a seller might derive by offering a purchaser such alternative financing. Public policy dictates the need to create affordable housing and the dream of one day owning one's own home, but unless changes are made to incentivize sellers to continue to take such risks, such dreams

will never become reality. We have witnessed the legislature's and judiciaries' intervention on behalf of defaulting purchasers during favorable real estate markets, now such favorable treatment must be extended to sellers in this declining market. The seller must be able to rely upon the availability of contract remedies and their application to the land installment contract must be preserved in order to promote alternative financing, and to provide sellers and purchasers alike with the intended benefit of their contractual bargains.

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**FN<sup>1</sup>** In addition to "land installment contract", this form of financing is known throughout the United States by a variety of names including "contract for deed", "land sale contracts" or a "long-term land contract". See Md. Real. Prop. Code Ann. §§10-101, *et. seq.*, and Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law* §3.26, at 68 (3d ed. 1994). Throughout this paper, the term "land installment contract" will be used to refer to this particular form of financing despite alternative nomenclature used by other jurisdictions.

**FN<sup>2</sup>** John E. Cribbet & Corwin W. Johnson, *Principles of the Law of Property* 171 (3d ed. 1989).

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FN<sup>3</sup> George E. Osborne, Handbook on the Law of Mortgages §20, at 29-31 (2d ed. 1970).

FN<sup>4</sup> Upon purchasers default, the third party trustee sells the property in a public sale and distributes the proceeds of the sale. Nelson & Whitman *Supra* note 1, §1.6 at 11, *Id.* §7.19 at 513.

FN<sup>5</sup> See John Mixon, Installment Land Contracts: A Study of Law Income Transactions with Proposals for Reform and a New Program to Provide Home Ownership in the Inner City, 7 Hous. L. Rev. 523, 530-535 (1970).

FN<sup>6</sup> See Pa. Stat. Ann. tit. 68 §907 (a) (1) (1994).

FN<sup>7</sup> See Me. Rev. Stat. Ann. Tit. 33 §482 (J) West (1964).

FN<sup>8</sup> See Md. Real Pro. Code Ann. § 10-103(d) which also prohibits periodic mortgage payments from exceeding the periodic payments due under the terms of the land installment contract.

FN<sup>9</sup> See, e.g., Iowa Code Ann. §§656.2, .4 (West 1987); and Minn. Stat. Ann. §559.21 (West 1990).

FN<sup>10</sup> See, Grant S. Nelson, The Contract for Deed As A Mortgage: The Case For The Restatement Approach, 1998 B.Y.U.L. Rev. 1111, 1115.

FN<sup>11</sup> See, Ariz. Rev. Stat. §§33-741 to 749 (1996) and Minn. Stat. Ann §559.21 (West 1990).

FN<sup>12</sup> Ohio Rev. Code Ann. §5313.01 (A)-(B), §5313.07 (Anderson 1989).

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FN<sup>13</sup> Okla. Stat. Ann. Title 16 §11A (West 1986).

FN<sup>14</sup> See, Petersen 707 P.2d 232 @240 (Cal. 1985).

FN<sup>15</sup> See, Lewis v. Premium Inv. Corp., 351 S.C. 167, 568 S.E. 2d 361 (S.C. 2002).

FN<sup>16</sup> See, Honey v. Henry's Franchise Leasing Corp., 415 P.2d 833 (Cal. 1966); Park Valley Corp. v. Bagley, 635 P.2d 65 (Utah 1981); Whitaker v. Whitaker, 169 Md. 312, 901 A. 2d 223 (Md. 2006).

FN<sup>17</sup> 301 N.E. 2d 641 (In.1973)

FN<sup>18</sup> *Id.* @ 650.

FN<sup>19</sup> See Sebastian v. Floyd, 585 S.W. 2d 381 (Ky. 1979).

FN<sup>20</sup> *Id.* @ 384.

FN<sup>21</sup> See, FN<sup>13</sup> and FN<sup>19</sup> infra.

FN<sup>22</sup> See, Nelson infra, @ 1132.

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FN<sup>23</sup> See, Barnett v. Oliver, 18 Kan. App. 2d 672, 858 P. 2d 1228 (Ka. 1993); Carpenter v. Smith, 147 Mich. App. 560, 383 N.W. 2d 248 (Mich. 1986).

FN<sup>24</sup> See, Barnett @ 1237, citing Hinshaw v. Smith, 131 Kan. 351, 291 P. 774 (1930).

FN<sup>25</sup> See, Milbrandt b. Huber, 149 Wis. 2d 275, 440 N.W. 2d 807 (1989); Ryker v. Stidham, 17 Wash.App. 83, 561 P. 2d 1103 (1977); Keene v. Schnetz, 13 Ohio App. 3d 87, 468 N.E. 2d 125 (1983).

FN<sup>26</sup> See, 7 Powell on Real Property, Paragraph 938.22[5], pp.84D-52 to 84D-53 (1993).

FN<sup>27</sup> See, Steinhoff v. Fisch, 847 P.2d 191 (Colo. App., 1992).

FN<sup>28</sup> See, Baldwin v. McDonald, 24 Wyo. 108, 156 P.27 (1916).



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