

Devil in the Details

Greater Disclosure of Residential Lease Status Required

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The Texas Real Estate Commission's (TREC) promulgated contracts previously addressed leases on residential properties for sale in two places. Paragraph 10 required copies of leases be delivered within seven days, and Paragraph 9 required any security deposits be turned over to the buyer at closing if the lease will continue. However, these general provisions do not address the many details a buyer should know when assuming a lease on a property.

With this in mind, TREC adopted a new Addendum Regarding Residential Leases that is required on all contracts with residential leases executed after March 31, 2021. This addendum is designed to make sure parties affirmatively agree on whether the lease is going to be terminated by the closing date and possession turned over to the buyer or assigned and assumed by the buyer. If assumed, the addendum helps ensure that the seller discloses and the buyer is aware of the terms of the lease and any potential issues regarding lease status or current or prior tenants. A copy of the addendum is provided at the end of this article.

The Takeaway

A new contract addendum adopted by the Texas Real Estate Commission addresses leases on residential properties for sale. Contracts with residential leases executed after March 31, 2021, must include this addendum.

What is Considered a Residential Lease?

The addendum defines "residential lease" as any lease of the property to a tenant. It includes not just the actual lease document but any addendum or amendment to the lease and any move-in condition form.

The addendum covers leases (whether oral or written, or long-term or short-term) that give a person the right to occupy the property.

It does not, however, cover a temporary lease between the parties to the contract. Under the addendum, the seller cannot execute or amend any residential lease

after execution of the addendum without the buyer's written consent.

Understanding the Structure of Addendum for Residential Leases

There are two sections to choose under the addendum—Sections A and B. Parties will choose one or the other when completing the form. If there is an existing residential lease on the property, it is imperative that the listing agent take a copy of this addendum to the listing appointment so the agent can review these two options and what they entail with the seller before the property is listed.

Box A should be checked when the seller is sure the lease can be terminated and possession of the property delivered to the buyer at closing. The seller's right to terminate the lease is determined by the terms of the existing lease. The seller should be encouraged to locate and review the lease documents early in the listing process so he will know how to proceed. If a seller is unsure whether he has the right to terminate, he should consult a real estate attorney to review the lease.

Remember, license holders cannot read and interpret lease terms for the seller. That would constitute the unauthorized practice of law. Keep in mind that if this box is checked, the seller will be in default of the contract if he cannot get the tenant out of the property on or before the closing date.

Box B should be checked when the lease is going to be assigned by the seller and assumed by the buyer at closing. If this box is checked, the seller will have additional obligations and representations under the addendum. These are discussed in the next sections.

Can this addendum be used for multiple leases on the property (for example, in a duplex or four-plex situation)? Yes, the addendum is designed to be used for all residential leases on the property. However, since the addendum form instructs license holders to choose *only* A or B, it anticipates the same disposition for all leases. In other words, all leases will be terminated, or all will be assigned. If the buyer wishes to live in one of the units and assume the lease on the other unit, the best practice is to use a different addendum for each unit.

Delivery of Lease Documents

If the buyer is going to assume a lease on the property, the seller has the obligation to deliver copies of the residential lease documents to the buyer under Section

B(1) of the addendum. Remember, the lease documents are defined by the addendum to include more than just the actual lease.

The seller has two choices regarding delivery, each with different consequences. He can either deliver copies of the residential lease documents prior to the execution of the contract or within three days after the contract's effective date. Similar to the Seller's Disclosure Notice provisions, if the seller does not deliver the lease documents prior to execution of the contract, the buyer will have a period of time after receiving the lease documents to terminate the contract for any reason and have his earnest money returned. Length of this period is negotiable by both parties. If the seller wants to avoid creating an additional option period for the buyer, the listing agent should encourage the seller to find the lease documents early in the process so they can deliver the documents to the buyer prior to executing the contract.

Can the license holder put a copy of the lease documents in the Multiple Listing Service (MLS) to satisfy the delivery of the lease documents prior to executing the contract? This is not a good idea as not all buyers—or their agents—may have access to the MLS. It may also create a violation of privacy action by the tenant under the lease. A best practice would be to note in the MLS that there are residential leases on the property, then send a copy of the lease documents to the buyer's agent when the buyer is contemplating submitting an offer on the property.

If the seller fails to deliver the documents within three days after the contract's effective date, the buyer can declare the seller in default at any time before delivery up to closing and seek whatever remedies the buyer elects under Paragraph 15 of the contract.

Obligations Regarding Tenant's Security Deposit

Section B(2) of the addendum should be familiar as it simply moved the provision regarding security deposits from Paragraph 9 of the previous contract to this addendum.

It reiterates the Texas Property Code provision that the seller is required to deliver any security deposits he holds to the buyer at closing, and the buyer is responsible for notifying the tenant that the buyer has acquired the property and holds the tenant's security deposit. The amount of the security deposit must be set out in the notice to tenant.

Disclosure of Residential Lease Status

Section B(3) is a significant change to selling property where a lease is assumed. It requires the seller to affirmatively acknowledge seven facts about the lease. These factors, which can be seen on the addendum at the end of this article, deal with the status of the lease, payment of rent, and any disputes or agreements with the current tenant or prior tenants.

A listing agent should review each of these statements with a seller who will be assigning a lease as part of the sale of the seller's property at the listing appointment. If significant issues exist, it might be best if the seller tries to resolve those issues prior to putting the property on the market. If any of the seven statements about the lease are not true at the time of contract, the seller can explain why that statement is not true using the space provided.

For example, Section B(3)(c) states that, to the seller's knowledge, no tenant has prepaid any rent. It is common in some areas to have the tenant prepay the last month's rent. If that were the case, the seller would have to insert an explanation in the space at the bottom of B(3) stating that tenant has prepaid the last month's rent for the month of _____ in the amount of \$_____. This will notify the buyer to negotiate for that amount to be transferred to the buyer at closing and to send a notice to the tenant after closing acknowledging possession of the last month's rent under the lease.

Change in Residential Lease Status Following Execution of the Contract

Under Section B(4), if at any time after the execution of the contract (with the addendum) one of the seven statements under Section B(3) becomes untrue, the seller has an obligation to notify the buyer and remedy the situation.

Time frames become particularly important in this section. The seller is required to *promptly* notify the buyer

that a statement became untrue. That means as soon as the seller finds out about it. The seller has an obligation to cure the condition making the statement untrue within seven days after giving the buyer notice that the statement became untrue. Note the addendum says, "Seller *shall* cure the condition . . .," which means the seller must make his best effort to cure the condition.

If the condition making the statement untrue persists beyond this seven-day period, the buyer has five days following the seven-day period to decide whether to terminate the contract and have the earnest money returned or waive the condition and close. If the buyer does not terminate within that five-day period, the buyer waives the right to terminate under this section.

Built-in Closing Extension

A unique feature of the addendum is the automatic extension of the closing date to allow the time frames to cure and election to terminate to play out.

The last sentence of Section B(4) provides that the closing date will be extended *daily as necessary* to afford the parties time to provide notices under this paragraph. So, depending on when the statement in B(3) becomes untrue, the closing date could be extended up to 12 days. Note that if the seller is able to cure the issue making the statement in B(3) untrue within the seven-day period, the buyer's right to terminate or waive does not arise. This is another set of timeframes that license holders will need to help their clients keep track of to navigate through the transaction.

Nothing in this publication should be construed as legal advice for a particular situation. For specific advice, consult an attorney. ♦

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ADDENDUM REGARDING RESIDENTIAL LEASES



CONCERNING THE PROPERTY AT: _____
(Street Address and City)

"Residential Lease" means any lease of the Property to a tenant including any addendum, amendment, or move-in condition form.

Seller may not execute any new Residential Lease or amend any Residential Lease without Buyer's written consent. Existing Residential Leases will have the following status at closing. (Check only A or B)

- A. **Termination of Residential Leases:** All Residential Leases must be terminated by closing. Seller shall deliver possession of the Property in accordance with Paragraph 10 of the contract with no tenant or other person in possession or having rights to occupy the Property. **[Notice: This paragraph will not amend or terminate any existing lease. Consult an attorney and refer to the Residential Leases for rights to terminate before agreeing to this provision.]**
- B. **Assignment and Assumption of Residential Leases:** Existing Residential Leases shall be assigned by Seller and assumed by Buyer at closing.
- (1) **Delivery of Residential Leases:** (Check one box only)
 (a) Buyer has received a copy of all Residential Leases.
 (b) Buyer has not received a copy of all Residential Leases. Seller shall provide a copy of the Residential Leases within 3 days after the Effective Date. Buyer may terminate the contract within _____ days after the date the Buyer receives the Residential Leases and the earnest money shall be refunded to Buyer.
- (2) At closing, Seller shall transfer security deposits (as defined under §92.102, Property Code), if any, to Buyer. At closing, Buyer shall deliver to the tenant a signed statement acknowledging that the Buyer has acquired the Property and is responsible for the return of the security deposit, and specifying the exact dollar amount of the security deposit.
- (3) Except as described below, and to Seller's knowledge for each Residential Lease:
(a) the Residential Lease is in full force and effect;
(b) no tenant is in default or in violation of the Residential Lease;
(c) no tenant has prepaid any rent;
(d) no tenant is entitled to any offset against rent;
(e) there are no outstanding tenant claims against Seller involving the Property;
(f) there are no pending disputes with any tenant or prior tenant; and
(g) there are no other agreements, options, or rights outside the Lease between Landlord and Tenant regarding the Property.

Explain if any of the above is not accurate (attach additional sheets if necessary): _____

- (4) Seller will promptly notify Buyer if Seller learns that any statement in Paragraph B(3) becomes untrue after the Effective Date. Seller shall cure the condition making the statement untrue within 7 days after providing the notice to Buyer. If the statement remains untrue beyond the 7-day period, Buyer may, as Buyer's sole remedy, terminate the contract within 5 days after the expiration of the 7-day period, by delivering notice to the Seller and the earnest money will be refunded to Buyer. If Buyer does not terminate the contract within the time required, Buyer waives the right to terminate. The Closing Date will be extended daily as necessary to afford the parties their rights and time to provide notices under this paragraph.

Buyer

Seller

Buyer

Seller

The form of this addendum has been approved by the Texas Real Estate Commission for use only with similarly approved or promulgated forms of contracts. Such approval relates to this contract form only. TREC forms are intended for use only by trained real estate license holders. No representation is made as to the legal validity or adequacy of any provision in any specific transactions. It is not intended for complex transactions. Texas Real Estate Commission, P.O. Box 12188, Austin, TX 78711-2188, (512) 936-3000 (www.trec.texas.gov) TREC No. 51-0.

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