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Notes

INSTALLMENT LAND CONTRACTS: DEVELOPING LAW IN VIRGINIA

An installment land sale contract¹ is a method of seller financing for land sales. The land contract, sometimes referred to as a "contract for deed" or "longterm contract," functions as a substitute for a mortgage or deed of trust.² Generally, in a mortgage, the seller conveys title to the property, and the buyer obtains financing by pledging the property as security for the purchase price of the land.³ The mortgagee has a lien on the buyer's title.⁴ In a deed of trust transaction, the buyer conveys title to the property to a third party to hold as trustee during the period of indebtedness.⁵ In a land contract, the seller finances the land sale retaining legal title to the property until the buyer makes the final installment payment.⁶

Land contracts are used most often in states in which mortgage law heavily favors the mortgagor.⁷ Pro-mortgagor law restricts the mortgagee's right to enforce the lien on the property by prescribing lengthy procedures for mortgage foreclosure.⁸ Sellers often prefer land contracts be-

¹ G. OSBORNE, G. NELSON, D. WHITMAN, *REAL ESTATE FINANCE LAW* § 3.25 (1979)[hereinafter cited as G. OSBORNE]. The installment land contract should be distinguished from the executory contract for the sale of land known as a binder, a marketing contract, or an earnest money contract. These shorter term contracts establish parties' rights during the period preceding the closing of a secured real estate transaction. *Id.*

² In an installment land contract, the property owner agrees to finance the conveyance of real estate to a purchaser. The seller generally retains legal title until the full contract price is paid. The buyer commonly takes possession of the property during the executory period of the contract. *See* G. OSBORNE, *supra* note 1, § 3.25, at 79.

³ The lender in a land sale secured by a mortgage is generally a third party commercial lender. Power, *Land Contracts As Security Devices*, 12 WAYNE L. REV. 391, 395 (1966)[hereinafter cited as Power]. The owner selling the land may finance the sale, however, conveying title to the buyer and retaining a lien on the property to secure payment of the purchase price. G. OSBORNE, *supra* note 1, § 1.5, at 10.

⁴ The "lien theory" of mortgage lending is the predominant theory in the United States. G. OSBORNE, *supra* note 1, § 1.5, at 10. Under the lien theory, the buyer is deemed to be the owner of the land. *Id.* § 4.2, at 118. Under the alternative theory, the "title theory," the mortgagee retains title to the property until the mortgage is satisfied or foreclosed. *Id.* § 1.5, at 10.

⁵ *Id.* § 1.6, at 11.

⁶ *See* note 2 *supra*.

⁷ G. OSBORNE, *supra* note 1, § 3.25, at 80.

⁸ *See id.* At common law, the mortgagee could foreclose the mortgagor's rights automatically upon default of payment. This "strict foreclosure" vesting title to the property in the mortgagee was a harsh remedy without recourse for the mortgagor. McGovern, *Forfeiture, Inequality of Bargaining Power, and the Availability of Credit: An Historical Perspective*, 74 Nw. U. L. Rev. 141, 145 (1979)[hereinafter cited as McGovern]. Most states

cause of possible tax advantages⁹ as well as the relative ease with which they can terminate the contract and regain unclouded title to the property.¹⁰ Because the seller is financing the sale, installment contracts enable low income buyers who could not qualify for a commercial mortgage loan to become property owners.¹¹ The simplicity of termination of the contract offsets the seller's risk in financing the sale.

The buyer under a land contract has fewer rights than under a mortgage. The buyer who fails to perform fully risks loss both of the land and any payments already made.¹² Traditionally, courts enforced forfeiture when a buyer breached a land contract.¹³ Recently, however, courts have begun to equalize the relative advantages and disadvantages under land contracts and to protect buyers from forfeiture.¹⁴

Although land contracts are not used commonly in Virginia,¹⁵ increased mortgage interest rates may leave a property owner with a choice of financing the sale of his land or not selling the property at all.¹⁶ The land contract is a financing technique that will enable a landowner to sell property at its peak market price despite tight mortgage money market conditions. Sellers must weigh the apparent simplicity of a land contract, however, against potential legal difficulties for both the seller and the buyer if either party fails to perform according to the terms of the contract.¹⁷ Law on the subject of land contracts in Virginia is undeveloped. As land contracts become more commonly used, however, Virginia's law is likely to develop in ways similar to that of other jurisdictions.

have developed mortgage foreclosure procedures to protect the rights of mortgagors. See G. OSBORNE, *supra* note 1, § 7.11, at 447. Many states allow a non-judicial foreclosure procedure known as "power of sale" foreclosure. In a "power of sale" proceeding, the mortgagee or trustee in a deed of trust follows statutorily prescribed procedures governing sale of the property and distribution of the proceeds. See *e.g.*, VA. CODE §§ 55-59.1 to 66.7 (Supp. 1980). A majority of states have adopted a judicial foreclosure procedure. On the mortgagor's default, the property sale is handled by a judicial officer or appointee following statutorily prescribed procedures. G. OSBORNE, *supra* note 1, § 7.16, at 466.

⁹ Property owners may choose to sell under a land contract to avoid capital gains tax. The seller may have to pay tax only on the installments collected each year rather than on the full sale price of the property. Comment, *Florida Installment Land Contracts: A Time for Reform*, 28 U. FLA. L. REV. 156, 158 n.10 (1975)[hereinafter cited as *Contracts*]: see I.R.C. § 453.

¹⁰ See text accompanying notes 43-47 *infra*. Courts generally look upon land contracts not as mortgage alternatives, but as executory contracts for the sale of land. *Contracts*, *supra* note 9, at 159.

¹¹ Comment, *Forfeiture: The Anomaly of the Land Sale Contract*, 41 ALB. L. REV. 71, 75 (1977)[hereinafter cited as *Forfeiture*]. See generally, Mixon, *Installment Land Contracts: A Study of Low Income Transactions, With Proposals for Reform and a New Program to Provide Home Ownership in the Inner City*, 7 HOUS. L. REV. 523 (1970).

¹² *Forfeiture*, *supra* note 11, at 73-74.

¹³ G. OSBORNE, *supra* note 1, § 3.26, at 80; see *Contracts*, *supra* note 9, at 159-60.

¹⁴ See text accompanying notes 48-69 *infra*.

¹⁵ See text accompanying notes 88-91 *infra*.

¹⁶ See Power, *supra* note 3, at 399-400; *Forfeiture*, *supra* note 11, at 75.

¹⁷ See Power, *supra* note 3, at 419-20.

In most cases in jurisdictions in which land contracts are common, the seller retains title to the property until the buyer has performed completely under the contract.¹⁸ Because the buyer's duty to perform in an executory land contract is a long term duty, the seller need only be willing and able to perform his contractual obligation after payment of the full contract price.¹⁹ In the interim, the buyer is at a disadvantage to challenge the contract on the basis of title problems the seller may have.²⁰ In land contracts, the buyer generally does not search the seller's title to verify its marketability prior to entering into the contract.²¹ As a result, the buyer may make a substantial investment in property with an encumbered title.²²

Additional title problems arise for the buyer in cases in which statutory liens are enforced against the seller. Liens on the seller's property arising under the Federal Tax Lien Act of 1966²³ take priority over the buyer's interest if filed prior to the date of the land contract.²⁴ To avoid tax lien difficulties or other title problems, the buyer must examine title to the property to assure that it is free of encumbrances.²⁵ Recording the land contract provides additional protection.²⁶ In the event of buyer's default in payment under a recorded contract, the seller must bring a judicial proceeding to effectuate a forfeiture and quiet title in himself.²⁷ A recorded contract will also establish a priority for the buyer over unrecorded or subsequently recorded liens against the seller's interest in the property.²⁸

During the executory period of the contract, both parties have a recognized interest in the property.²⁹ Most jurisdictions recognize the buyer's interest in an executory land contract as a mortgageable asset.³⁰ The mortgagee of a buyer's interest is functionally in the position of a holder of a traditional second mortgage.³¹ Most jurisdictions require the seller to notify the mortgagee in the case of a forfeiture under the original con-

¹⁸ See G. OSBORNE, *supra* note 1, § 3.25, at 79; *Forfeiture*, *supra* note 11, at 74.

¹⁹ The seller's duty to convey is independent of the buyer's duty to make installment payments. Consequently, a buyer's remedies are not available until the buyer has paid the purchase price of the land. *Forfeiture*, *supra* note 11, at 88.

²⁰ See note 19 *supra*.

²¹ See G. OSBORNE, *supra* note 1, § 3.30, at 101.

²² *Id.*

²³ I.R.C. §§ 6321-6326 (1966).

²⁴ See *id.*, § 6323.

²⁵ Federal tax liens are valid and take priority only after notice has been filed by the Secretary. *Id.*

²⁶ Most states allow recording of an executory land contract as a mortgage or other security device. See e.g., VA. CODE § 55-95 (1974 repl. vol.).

²⁷ See G. OSBORNE, *supra* note 1, § 3.30, at 101-02.

²⁸ See e.g., I.R.C. § 6323(h)(6)(1966).

²⁹ G. OSBORNE, *supra* note 1, § 3.25, at 79.

³⁰ *Id.* § 3.32, at 108.

³¹ *Id.* at 107-08.

tract.³² In any case, assuming the mortgagee learns of an impending forfeiture of the interest, the mortgagee's options should be the same as the rights of any second mortgagee.³³

Because the seller retains legal title to the property, he generally retains all the rights of ownership. The seller may, for example, bring an action in waste against the buyer in possession. Creditors can levy on the seller's interest in the property.³⁴ Under the Bankruptcy Code,³⁵ the seller's trustee may reject the executory land contract.³⁶ The buyer's options to perfect an interest in the bankrupt seller's property are very limited.³⁷ The seller under a land contract may mortgage the property to a third party lender or may sell the property to a subsequent buyer.³⁸ In theory, the buyer will have no legal recourse against the encumbering seller until the seller's duty to perform arises.³⁹ Some courts, however, have recognized equitable ownership in the buyer.⁴⁰ Courts generally hold that once the seller's duty arises, the buyer has an equitable lien⁴¹ on the property enforceable on the seller's default.⁴²

³² Note, *Mortgage of a Vendee's Interest in an Installment Land Contract—Mortgagee's Right Upon Default*, 43 Mo. L. Rev. 371, 373 (1978) [hereinafter cited as *Vendee's Interest*]. To preserve the right of notice of imminent forfeiture, the mortgagee of the land contract buyer's interest must notify the land contract seller of the mortgage. In some states, recordation of the mortgage is sufficient notice to the seller to preserve the right. In at least one state, the seller must have actual notice of the mortgage before the seller is bound to notify the mortgagee of a forfeiture. *Id.*

³³ G. OSBORNE, *supra* note 1, § 3.32, at 108. When a buyer's mortgagee learns of an impending forfeiture by the buyer under the original land contract, he may either exercise the buyer's option to redeem the contract, where that option exists, or he may foreclose on his mortgage, however, he risks losing money since a purchaser at a foreclosure sale would take the property subject to the seller's right of forfeiture. *Vendee's Interest*, *supra* note 32, at 376. At any rate, if the mortgagee is entitled to notice and a forfeiture takes place without that notice, the forfeiture will be held not to impair the mortgagee's rights. *Id.* at 374.

³⁴ See *Forfeiture*, *supra* note 11, at 76.

³⁵ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), (to be codified at 11 U.S.C. §§ 101-151326).

³⁶ *Id.* § 365(i). The trustee in bankruptcy may reject an executory land contract if the buyer is not in possession of the property. The buyer does have a lien on the property for payments made, but has the status of a general creditor for damages under the contract. *Id.* § 365(j).

³⁷ In order to claim title in a seller's bankruptcy action, a buyer in possession must complete the payments due under the contract. *Id.* § 365(i); see G. OSBORNE, *supra* note 1, § 3.30, at 103.

³⁸ See G. OSBORNE, *supra* note 1, § 3.30, at 101.

³⁹ See note 19 *supra*.

⁴⁰ *E.g.* Richardson v. Providence Wash. Ins. Co., 38 Misc. 2d 593, 604, 237 N.Y.S. 2d 893, 904 (Sup. Ct. Tomkins County 1963).

⁴¹ An equitable lien arises from a contract which shows an intention to charge a certain piece of property with a debt or obligation, or is declared by a court of equity. *Owensboro Banking Co. v. Lewis*, 269 Ky. 277, —, 106 S.W.2d 1000, 1004 (Ct. App. 1937).

⁴² In order to enforce the lien on the property, the buyer must bring an action for specific performance. Because specific performance is an equitable remedy, it is unavailable to a buyer who has defaulted or otherwise breached the contract. See D. DOBBS, *REMEDIES*, § 2.3, at 40 (1973)[hereinafter cited as D. DOBBS].

A seller's remedies for buyer's breach of a land contract derive from traditional contract law remedies.⁴³ On buyer's default, a seller may choose whether to affirm or disaffirm the contract.⁴⁴ If the seller affirms the contract, he may sue for specific performance, sue for the installments due under the contract, or sue to foreclose the buyer's rights.⁴⁵ The seller's remedies on disaffirming the contract are a suit for damages or a suit to quiet title.⁴⁶ In either case, the buyer forfeits his rights under the contract and his interest in the land.⁴⁷

In states with no statutory control of land contracts, courts have nonetheless fashioned judicial remedies to limit forfeiture of rights in land.⁴⁸ Relying on contract principles, mortgage law, or an imprecise combination of the two,⁴⁹ courts have developed several remedies for buyers suing to set aside a forfeiture. The first remedy is a buyer's claim of waiver or estoppel.⁵⁰ If a seller has accepted late installment payments, he cannot subsequently terminate the contract and work a forfeiture on the buyer.⁵¹ The seller can preserve the contract right to forfeiture even after accepting a late payment from the seller by giving proper notice that time is of the essence in the contract.⁵²

Some courts have allowed a buyer to circumvent the seller's remedy of forfeiture by allowing an equity of redemption⁵³ to the buyer in a suit for specific performance of the contract.⁵⁴ Where it is recognized by the

⁴³ *Forfeiture*, *supra* note 11, at 77.

⁴⁴ *Id.* at 79. Even though a buyer is in default, his default may not amount to a total breach of the contract. If the contract continues in force, the seller must seek rescission in equity. *Contracts*, *supra* note 9, at 171.

⁴⁵ *Forfeiture*, *supra* note 11, at 87; see Comment, *Installment Land Contracts for the Sale of Land in Missouri*, 24 Mo. L. Rev. 240, 243 (1959)[hereinafter cited as *Installment Land Contracts*].

⁴⁶ See *Forfeiture*, *supra* note 11, at 79; *Installment Land Contracts*, *supra* note 45, at 243.

⁴⁷ A forfeiture under a land contract is a loss of rights in two senses. The buyer loses the money tendered in part performance of the contract, and he loses his expectancy, the value of the seller's promise. McGovern, *supra* note 8, at 141.

⁴⁸ G. OSBORNE, *supra* note 1, § 3.28, at 84. Courts generally limit a buyer's forfeiture to cases in which the buyer has paid only a few installments or has willfully breached the contract. *Contracts*, *supra* note 9, at 160-62; see note 44 *supra*.

⁴⁹ G. OSBORNE, *supra* note 1, § 3.28, at 84-85; see *Contracts*, *supra* note 9, at 162.

⁵⁰ G. OSBORNE, *supra* note 1, § 3.28, at 85.

⁵¹ *Forfeiture*, *supra* note 11, at 105.

⁵² *Id.*

⁵³ In the law of mortgages, a mortgagor has a right after default to tender performance under the mortgage and receive clear title to the mortgaged property. G. OSBORNE, *supra* note 1, § 7.1, at 425. Some courts have imputed this concept to land contract situations. In those jurisdictions, the buyer, notwithstanding a default, may pay the balance owing on the contract and reinstate the contract. In some states the buyer may pay only the arrearages to reinstate the contract. *Id.* § 3.28, at 87; e.g., *Walker v. Nunnenkamp*, 84 Idaho 485, 373 P.2d 559 (1962); *Nelson v. Robinson*, 184 Kan. 340, 336 P.2d 415 (1959); see *Contracts*, *supra* note 9, at 165.

⁵⁴ The mortgage law equity of redemption is available only after default. See note 53 *supra*. A land contract buyer in default, however, is generally denied an equitable action for

court, the equity of redemption allows the buyer one last chance to make amends for his missed payments.⁵⁵ Courts may impose various restrictions on the right of redemption, but in general, the remedy does not require a prior waiver of the timely payment requirement by the seller.⁵⁶ In addition, under the equity of redemption remedy, the buyer may safely discontinue performance without jeopardizing his standing in equity.⁵⁷

In states that do not recognize the equity of redemption remedy, courts have chosen other means of reforming the law of land contracts.⁵⁸ In order that a buyer not lose all his "equity" in the land, courts have allowed rescission⁵⁹ and restitution.⁶⁰ The aim of restitution is to return both parties as nearly as possible to their relative pre-contract positions.⁶¹ Courts allowing restitution have allowed the buyer to recover payments made to the extent those payments exceed the amount of the seller's damages.⁶²

Recent legislative developments concerning land contracts increase a buyer's defenses to forfeiture, and may negate the very advantages for which the seller attempted to contract.⁶³ The most common statutory change in land contract law is the imposition of a statutory grace period for the buyer to make an installment payment.⁶⁴ A second protection for

specific performance. *See* note 42 *supra*. Courts have not required a waiver of default to allow a specific performance under the equity of redemption concept. Rather, they have held that for redemption purposes, land contracts will be treated as mortgages. G. OSBORNE, *supra* note 1, § 3.28, at 88.

⁵⁵ The land contract equity of redemption in some states is actually more lenient than mortgage redemption rights. A mortgagor's right of redemption can be exercised only by tendering the accelerated balance due on the mortgage. A buyer under a land contract, however, may be able to redeem the contract by paying only the arrearages. G. OSBORNE, *supra* note 1, § 3.28, at 87.

⁵⁶ *See* note 54 *supra*.

⁵⁷ *See Forfeiture, supra* note 11, at 103.

⁵⁸ G. OSBORNE, *supra* note 1, § 3.28, at 91.

⁵⁹ The term "rescission" is often used when a contract is terminated under its terms or cancelled by one party by reason of a breach. Technically, rescission is a term of art in contract law referring to a mutual agreement to discharge contractual duties. J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* § 21-2, at 758 (2d ed. 1977) [hereinafter cited as J. CALAMARI & J. PERILLO]. In land contract law, courts and commentators refer to cancellation of the contract as a rescission. D. DOBBS, *supra* note 42, § 12.9, at 844. The term is most often used when a court allows cancellation for a buyer's default of payment and the seller's subsequent attempts to recover the property through exercise of a forfeiture. *Id.*

⁶⁰ A claim of restitution is based on the principle of unjust enrichment of one of the parties to a contract. J. CALAMARI & J. PERILLO, *supra* note 59, § 15-2, at 571. In a land contract case in which the buyer defaults and the seller attempts to work a forfeiture, the buyer's breach does not give rise to his right to restitution, rather the seller's retention of both the land and the buyer's payments gives rise to the buyer's right of restitution. D. DOBBS, *supra* note 42, § 12.14, at 863.

⁶¹ J. CALAMARI & J. PERILLO, *supra* note 59, § 15-1, at 570.

⁶² A buyer can recover excess payments even if he willfully breached the land contract. McGovern, *supra* note 8, at 164.

⁶³ *See* G. OSBORNE, *supra* note 1, § 3.27, at 81.

⁶⁴ *E.g.*, IOWA CODE §§ 656.1-6 (1950). The imposition of a grace period does not elimi-

the buyer is the introduction of specific, prescribed cancellation procedures.⁶⁵ In a typical statute, the seller is required to identify the subject property, specify the terms of the contract that the buyer has violated, and give the buyer notice of the period in which he can cure his default.⁶⁶ In order to terminate the buyer's interest, the seller must follow the statutory procedures exactly.⁶⁷ In at least two states, the legislatures have formalized land contract cancellation even further. In those states, sellers must follow the established procedures for mortgage foreclosure.⁶⁸ Under foreclosure statutes, the property is sold and the proceeds are used to satisfy the remaining debt. The buyer may recover any surplus income from the foreclosure sale as payment for his "equity" in the property.⁶⁹ While legislation in some states has imposed foreclosure proceedings on contracts, most courts have refused to impose those proceedings on a seller without legislative direction.⁷⁰

Land buyers in mortgage or deed of trust transactions have attacked the constitutionality of foreclosure proceedings in those transactions.⁷¹ Mortgagors and purchasers under a deed of trust have asserted that the fourteenth amendment due process notice and hearing requirements applied in non-land property deprivation cases should apply equally to land sales.⁷² Recent due process cases have held that a state cannot deprive anyone of a significant property interest without prior notice and an opportunity for a hearing, except in extraordinary situations, or in cases in which there is a valid waiver of those due process rights.⁷³ While it is

nate forfeiture under the land contract. The grace period merely mitigates the harshness of the seller's forfeiture remedy by giving the buyer an opportunity to cure his default. If the buyer fails to cure within the grace period, the seller recovers. G. OSBORNE, *supra* note 1, § 3.27, at 81. The grace period may be a specific, fixed period for all situations, as in the Iowa statute, or it may vary according to the amount the buyer has paid under the contract. See e.g., MINN. STAT. § 559.21 (Supp. 1980).

⁶⁵ See note 63 *supra*.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ G. OSBORNE, *supra* note 1, § 3.27, at 83. Maryland law prohibits forfeiture in land contract sales of residential property to non-corporate buyers. MD. REAL PROP. CODE ANN. §§ 10-101 to 108 (1974 & Supp. 1979). The approved Maryland procedure is foreclosure identical to that used for a mortgage. *Id.* The Oklahoma statute converts all land contracts to mortgages, thus eliminating the possibility of a buyer forfeiture. OKLA. STAT. tit. 12 § 686 (1960).

⁶⁹ *But see* note 48 *supra*.

⁷⁰ G. OSBORNE, *supra* note 1, § 3.28, at 95.

⁷¹ *Id.* at 98. See Dunn, *Selected Current Legal Issues in Mortgage Financing*, 13 REAL PROP. & TR. J. 812, 812 (1978)[hereinafter cited as Dunn]. See generally, D. Leen, P. Galbraith & J. Gant, *Due Process and Deeds of Trust—Strange Bedfellows?*, 48 WASH. L. REV. 763 (1973)[hereinafter cited as *Strange Bedfellows*].

⁷² *Strange Bedfellows*, *supra* note 71, at 763-64.

⁷³ See e.g., *Fuentes v. Shevin*, 407 U.S. 67 (1972). In *Fuentes*, a Florida statute allowing prejudgment replevin of household goods sold under a conditional sales contract was struck down by the Supreme Court as an unconstitutional deprivation of property without due process. The Court held that state action to seize goods was constitutional only if the buyer had notice and an opportunity for a hearing at a meaningful time. *Id.* at 79-80.

arguable that all the conditions for requiring notice and hearing are present in a mortgage or deed of trust,⁷⁴ the conditions are less clearly present in a land contract.⁷⁵

In any event, the defenses available to a mortgagee to counter a constitutional attack on a power of sale mortgage⁷⁶ are even more persuasive in land contract cases. A mortgagee's main defenses to constitutional attack are the lack of state action⁷⁷ and the contractual waiver of due process rights.⁷⁸ Judicial foreclosure involves state action.⁷⁹ Non-judicial foreclosure under a power of sale mortgage or deed of trust, however, does not involve state action.⁸⁰ Unless a state law converts land contracts to mortgages and requires judicial foreclosure,⁸¹ a court could not find state action in a land contract. As state legislatures and courts increasingly recognize and regulate land contracts, however, buyers' claims of state action

⁷⁴ To invoke fourteenth amendment due process protection, a claimant must show that there is state action to deprive him of a property interest. *Fuentes v. Shevin*, 407 U.S. 67, 86 (1972); see note 77 *infra*. If there is state action, the claimant must show that there was no valid contractual waiver of the constitutional right to adequate notice and an opportunity for a hearing on the issue of property deprivation. *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 187 (1970); see *Dunn*, *supra* note 71, at 812-13. Judicial involvement in foreclosure procedures constitutes a state action, but judicial procedures provide for adequate notice and hearing to provide due process. *G. OSBORNE*, *supra* note 1, § 7.18, at 474. The clear trend in power of sale mortgage cases is to find no state action. *E.g.*, *Levine v. Stein*, 560 F.2d 175 (4th Cir. 1977), *cert. denied*, 434 U.S. 1046 (1978); *Northrip v. Federal Nat. Mortgage Ass'n*, 527 F.2d 23 (6th Cir. 1975).

⁷⁵ In a land contract, the contract is generally terminated without judicial intervention. Not only is there insufficient state action, but the terms of the contract usually provide for the forfeiture on buyer's default. This contractual waiver, absent unequal bargaining power sufficient to set aside the agreement, effectively eliminates a constitutional challenge to a land contract. See *G. OSBORNE*, *supra* note 1, § 3.29, at 99-100; *cf.* *Nowlin v. Professional Auto Sales, Inc.*, 496 F.2d 16 (8th Cir. 1974), *cert. denied*, 419 U.S. 1006 (1974) (self help repossession by seller of goods sold under conditional sales contract not state action).

⁷⁶ In a power of sale mortgage, the mortgagee bargains for a right to foreclose without judicial intervention. See note 8 *supra*. Upon mortgagor's default, the mortgagee sells the property to satisfy the debt. See *G. OSBORNE*, *supra* note 1, § 7.19, at 475.

⁷⁷ Fourteenth amendment due process is applicable to all states. U.S. CONST. amend. XIV, § 1. State action to deny any citizen due process is unconstitutional. Courts have found state action on several theories. Actions by state officials in their official capacities, whether or not authorized by state law, are state actions. See, *e.g.*, *Griffin v. Maryland*, 378 U.S. 130, 135 (1964); *Shelley v. Kraemer*, 334 U.S. 1, 14-18 (1948). An act by an individual which is normally exercised by the state is a state action under the theory that the law permits private exercise of a traditional state function. *Hall v. Garson*, 430 F.2d 430 (5th Cir. 1970). Statutes and regulations which codify common law rights of action make exercise of those rights a state action. *Palmer v. Columbia Gas of Ohio, Inc.*, 479 F.2d 153 (6th Cir. 1973). Permissive state statutes which allow a deprivation of constitutional rights are deemed a state action to encourage that deprivation. *Reitman v. Mulkey*, 387 U.S. 369 (1967).

⁷⁸ See note 76 *supra*.

⁷⁹ *G. OSBORNE*, *supra* note 1, § 7.18, at 474. If judicial procedures are followed, there is no problem with constitutional due process. *Id.*

⁸⁰ See text accompanying note 75 *supra*.

⁸¹ See text accompanying notes 68-70 *supra*.

to abridge due process become more persuasive. In any event, in cases involving state action, courts will uphold a valid contractual waiver of rights. If, after close scrutiny, a court finds a valid waiver of due process rights in a land contract, the forfeiture provision in the contract will be binding on the buyer.⁸³

If both parties perform according to the terms of the contract, the seller must convey good title to the buyer after full payment of the contract price. Because of the long executory period of the land contract, a buyer's remedies are limited. The buyer's remedies are not available until the buyer has fully paid the purchase price of the land.⁸³ If at the time appointed for conveyance of the title, the seller is unable to deliver good title, the buyer will have a right of action for breach against the seller.⁸⁴ When the seller breaches, the buyer's remedies include action to recover installment payments made, a suit for damages, termination of the contract, enforcement of the contract through an action for specific performance, or, in limited circumstances, reinstatement of the contract.⁸⁵

The question of remedies for either party to a land contract in Virginia can only be settled by reviewing authorities in related areas of law. There are few cases in Virginia recorded law dealing directly with land contracts.⁸⁶ Recent developments evidence an increased use of land contracts in Virginia, however, and highlight the need to clarify Virginia law on the subject.⁸⁷

The predominant instrument for conveyance of property in Virginia is

⁸² Cf. *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 188 (1970).

⁸³ See note 19 *supra*.

⁸⁴ See *Forfeiture*, *supra* note 11, at 91.

⁸⁵ *Id.*

⁸⁶ Predominantly, land contract cases in Virginia are cases involving binder contracts. At least three known land contract cases have arisen in Virginia since 1977. *Waskey v. Thomas*, 218 Va. 109, 235 S.E.2d 346 (1977), involved a seller's breach by misrepresentation of ability to convey title. The two most recent cases concerning land contract law in Virginia both deal with the use of land contracts to circumvent mortgage due-on-sale clauses. See *Williams v. First Fed. Sav. & Loan Ass'n of Arlington*, No. 80-308-A (E. D. Va. June 17, 1980). Sellers in *Williams* created a "land trust" naming themselves as trustees, and selling a "beneficial interest" to the buyers. The sellers urged that they were thus selling personal property rather than real property, and that the seller's mortgagee could not foreclose to collect the outstanding balance of the mortgage under the due-on-sale clause in the mortgage. The district court treated the case as a question of interpretation of federal law and regulations promulgated by the Federal Home Loan Bank Board, and held for the defendant mortgagee. Slip op. at 8. The court held the seller's land contract sale a sufficient transfer to trigger the due-on-sale clause in their mortgage. The second recent case was heard in the Prince William County Circuit Court. See *Harney, Court Ruling Hits Some Va. Home Sellers*, *Wash. Post*, March 12, 1980, at C-1, col. 1. The Prince William County court held that sale of property using a land contract can trigger a foreclosure by the seller's mortgagee. *Id.* Even though legal title is not transferred from the seller in a land contract, the court found, as did the *Williams* court, that a sale under a land contract could invoke the seller's mortgagee's rights of foreclosure under a due-on-sale clause. *Id.*

⁸⁷ The recent case decided in Prince William County Circuit Court focused attention on the growing use of land contracts in Northern Virginia. See note 86 *supra*.

the deed of trust.⁸⁸ Common law mortgage foreclosure procedure is an extended judicial procedure that sellers can avoid by using the deed of trust.⁸⁹ In Virginia, the trustee has only a lien on the buyer's title for the specific purpose of securing the payment of the purchase price.⁹⁰ The trustee may initiate a non-judicial foreclosure proceeding and sell the pledged property to satisfy the secured debt.⁹¹

Even though deeds of trust predominate in Virginia, nothing in Virginia law precludes use of a land contract to convey land. The Virginia Statute of Frauds⁹² voids land contracts that are not in writing.⁹³ The recording statute validates duly recorded contracts.⁹⁴ The Code of Virginia (Code) does not recognize possession by the buyer as notice of the buyer's interest to subsequent purchasers for value.⁹⁵ Read together, two Code sections on constructive notice appear to imply notice from recordation of a land contract only to those under a legal obligation to search title.⁹⁶ Since buyers under a land contract have no obligation to search title, they cannot be said to have constructive notice of a prior land contract or mortgage.⁹⁷

Nothing in Virginia law of mortgages or binder contracts⁹⁸ precludes either party from encumbering the property during the executory period of the contract. In a deed of trust transaction, the trustee may not convey or encumber the title except in the case of default on the loan secured by the deed.⁹⁹ The trust creditor in a deed of trust has no estate in or right of possession of the property.¹⁰⁰ The buyer may transfer his interest in

⁸⁸ 13A MICHIE'S JURISPRUDENCE, *Mortgages and Deeds of Trust*, § 2 (1978 repl. vol.) [hereinafter cited as MICHIE'S].

⁸⁹ The common law mortgage foreclosure procedure in Virginia requires judicial involvement in sale of the mortgaged property. See *Morgan v. Glendy*, 92 Va. 86, 88, 22 S.E. 854, 855 (1895); *Taylor's Adm'rs v. Chowning*, 30 Va. (3 Leigh) 654, 664 (1832). The mortgagor had the duty to object to a non-judicial sale by the mortgagee, however, or he waived his right of redemption against the purchaser. *Taylor's Adm'rs v. Chowning*, 30 Va. (3 Leigh) at 666.

⁹⁰ See *Gravatt v. Lane*, 121 Va. 44, 49, 92 S.E. 912, 913 (1917); 13A MICHIE'S, *supra* note 88, at § 37. Under a deed of trust to secure a debt, the grantor [buyer] continues as the real owner and may sell and deal with the pledged property as the owner. *Lowry v. Gills*, 143 Va. 79, 85, 129 S.E. 269, 271 (1925).

⁹¹ See *Gravatt v. Lane*, 121 Va. at 49, 92 S.E. at 913.

⁹² VA. CODE § 11-1 (1978).

⁹³ *Id.*

⁹⁴ *Id.* § 55-95 (1974 repl. vol.).

⁹⁵ *Id.* § 55-96 (Supp. 1980).

⁹⁶ See *Bond v. Crawford*, 193 Va. 437, 69 S.E.2d 470 (1952).

⁹⁷ Every land contract buyer should search title prior to signing the contract to determine if the seller is capable of conveying good title to the property at the completion of the contract. See *Waskey v. Thomas*, 218 Va. 109, 235 S.E.2d 346 (1977); text accompanying notes 21-22 *supra*.

⁹⁸ See tit. 55 VA. CODE.

⁹⁹ See *Gravatt v. Lane*, 121 Va. 44, 49, 92 S.E. 912, 913 (1917); 13A MICHIE'S *supra* note 88, at § 54.

¹⁰⁰ 13A MICHIE'S, *supra* note 88, at § 57. The trust creditor has a chose in action. The deed of trust may be enforced at suit of or for the benefit of the trust creditor. *Castleman v.*

the property as security subject to the senior lienor interests of the lender and the trustee.¹⁰¹ In land contracts, then, there is no reason to believe either party would be restrained from encumbering the property to the extent of his interest.

In deed of trust or mortgage financing, the buyer and seller often sign a short term land contract, known as a binder contract, pending completion of arrangements for longer term mortgage or deed of trust financing. Virginia courts have established that binder contracts create an equitable estate in the property in the buyer, and an equitable interest in the purchase money in the seller.¹⁰² From the date of execution of a binder contract, the buyer is entitled to rents and profits and the seller is entitled to interest on the contract price.¹⁰³ From the date of execution of the contract, the buyer acquires full equitable estate in the land and may encumber it to the extent of his interest.¹⁰⁴ Legal title remains with the seller in a land contract, however, and any claim on the seller's interest in the property will take priority over a claim against a buyer's interest.¹⁰⁵

In Virginia, time is not of the essence in the performance of a real estate binder contract unless expressly made so by the terms of the contract.¹⁰⁶ If a binder contract contains a time of the essence clause, the sellers are under no duty to inform buyers that they will not sell the property after the scheduled date.¹⁰⁷ When time is of the essence in a binder contract, and the buyer fails to close on schedule, the seller may

Berry, 86 Va. 604, 607, 10 S.E. 884, 884 (1890).

¹⁰¹ See *Lambert v. Nanny*, 16 Va. (2 Munf.) 196, 199 (1811).

¹⁰² Under a land contract, legal title remains with the seller. *Russo v. Leary*, 330 F.2d 572, 573 (4th Cir. 1964) (applying Virginia law). There is no implied vendor's lien in Virginia, but a seller can retain a vendor's lien by express reservation of the lien in the contract, or by retaining legal title to the property until the purchase price is fully paid. *Day v. Hale*, 63 Va. (22 Gratt.) 146, 163 (1872). Since the seller in a land contract retains title to the property during the executory period, he will have the rights and protections of a common law vendor's lien under a land contract. A common law vendor's lien has the nature of an implied lien. See *Stephens v. Hutchison*, 47 Va. (6 Gratt.) 147, 148-49 (1849). It is a lien for the balance of the purchase price due under the contract. *Day v. Hale*, 63 Va. (22 Gratt.) at 163. The advantage of the vendor's lien is that the vendor may enforce it outside the settlement of the general estate. *Armentrout v. Gibbons*, 71 Va. (30 Gratt.) 632, 650 (1878).

¹⁰³ *Carmichael v. Snyder*, 209 Va. 451, 454-55, 164 S.E.2d 703, 706 (1968); *Sale v. Swann*, 138 Va. 198, 211, 120 S.E. 870, 876 (1924).

¹⁰⁴ *Sale v. Swann*, 138 Va. 198, 208, 120 S.E. 870, 873 (1924).

¹⁰⁵ See *Miller v. Kemp*, 157 Va. 178, 191-93, 160 S.E. 203, 211 (1931); 19 *MICHE'S*, *supra* note 88, Vendor & Purchaser, § 25 (1979 repl. vol.).

¹⁰⁶ *Beckett v. Kornegay*, 150 Va. 636, 640-41, 143 S.E. 296, 297 (1928). In an action at law, the time fixed for completion of the executory contract is of the essence of the contract. *Id.* In equity, time is not of the essence of the contract unless expressly made so. *Id.* See also *Wood v. Wood*, 216 Va. 922, 224 S.E.2d 159, 161 (1976). To make time of the essence, the seller must give the buyer notice, and must give the buyer a reasonable time for performance. *Boston v. Shackelford*, 162 Va. 733, 755, 175 S.E. 625, 633 (1934). If time is not of the essence, equity will enforce the contract rather than allow forfeiture. See *Sims v. Nidifer*, 203 Va. 749, 752, 127 S.E.2d 85, 88 (1962).

¹⁰⁷ *Schulze v. Kwik-Chek Realty Co.*, 212 Va. 111, 112, 181 S.E.2d 629, 630 (1971).

rescind the contract.¹⁰⁸ When the buyer fails to perform at all under the contract, the seller also has a right of reentry.¹⁰⁹ He may bring an action in equity for specific performance,¹¹⁰ or may sue at law for the purchase price.¹¹¹ In an installment land contract in which time is not expressly of the essence, the Virginia Supreme Court has ruled that the seller cannot forfeit the buyer's rights under the contract without notice to the buyer.¹¹²

A buyer under a binder contract in Virginia may likewise rescind the contract. A buyer's right of rescission arises in cases in which the seller is unable to perform.¹¹³ If the buyer tenders full price of the property within the contract period, the seller is entitled to a reasonable grace period to convey good title.¹¹⁴ Traditionally, the buyer's right to rescind or enforce a land contract did not arise until the purchase price was paid.¹¹⁵ In a recent case involving a Virginia land contract, however, the court held that the buyer may rescind if he learns that the seller cannot convey good title.¹¹⁶ If the buyer chooses to enforce the contract, he may bring an action for specific performance.¹¹⁷ On seller's breach, the buyer has a right to damages at law.¹¹⁸

¹⁰⁸ See *Beckett v. Kornegay*, 150 Va. 636, 641-42, 143 S.E. 296, 297 (1928). *But see* *Cranford v. Hubbard*, 208 Va. 689, 694-95, 160 S.E.2d 760, 763-64 (1968) (rescission allowed in case in which time was not expressly of the essence of the contract, but parties had bargained for date agreed for closing).

¹⁰⁹ See *Feuchtenberger v. Williamson*, 137 Va. 578, 583, 120 S.E. 257, 259 (1923).

¹¹⁰ *Definite Contract Bldg. & Loan Ass'n v. Tumin*, 158 Va. 771, 783, 164 S.E. 562, 566 (1932). When a seller elects to bring a suit in equity for specific performance, the seller is not deemed to have made an election of remedies. He may still bring an action for damages under the contract. *Jennings v. Realty Developers, Inc.*, 210 Va. 476, 480, 171 S.E.2d 829, 834 (1970).

¹¹¹ See *Definite Contract Bldg. Ass'n v. Tumin*, 158 Va. 771, 783, 164 S.E. 562, 566 (1932).

¹¹² *East v. Atkinson*, 117 Va. 490, 494, 85 S.E. 468, 469 (1915); *see* note 105 *supra*.

¹¹³ The general rule is that a seller need not be able to convey good title until the buyer has fully performed under the contract. *Jennings v. Realty Developers, Inc.*, 210 Va. 476, 479-80, 171 S.E.2d 829, 832 (1970); *Mundy v. Garland*, 116 Va. 922, 936, 83 S.E. 491, 495 (1914).

¹¹⁴ See *Mundy v. Garland*, 116 Va. 922, 936-37, 83 S.E. 491, 495 (1914).

¹¹⁵ *Newberry v. Ruffin*, 102 Va. 73, 78, 45 S.E. 733, 734 (1903).

¹¹⁶ *Waskey v. Thomas*, 218 Va. 109, 112, 235 S.E.2d 346, 348 (1977).

¹¹⁷ See *Turney v. Smith*, 211 Va. 810, 814, 180 S.E.2d 509, 512-13 (1971); note 105 *supra*. *But see* note 102 *supra*.

¹¹⁸ *Davis v. Buery*, 134 Va. 322, 339, 114 S.E. 773, 777 (1922). A suit for damages rather than for specific performance indicates that the buyer has taken the contract as broken. A buyer's remedy in a suit at law for damages will depend on whether the seller's inability to convey on the date set in the contract is a result of the seller's bad faith. 134 Va. at 339-40. If the seller has acted in good faith, the measure of damages for the buyer is the contract price. The buyer can recover the actual price paid and interest thereon. *Id.* at 341. If the seller has acted in bad faith, however, the buyer may recover for the loss of his bargain. *Id.* at 340. In an equitable action for specific performance, however, the court may extend the time for seller's performance. See text accompanying note 114 *supra*. If the seller is willing and able to convey and the buyer refuses for whatever reason, the buyer cannot recover payments already made. 19 MICHÆ's *supra* note 88, Vendor & Purchaser, § 106 (1979 repl.

The traditional seller's remedy for breach of a binder contract in Virginia is specific performance.¹¹⁹ The seller is also entitled to damages on buyer's breach.¹²⁰ A seller under a land contract would likely be less interested in compelling the buyer to perform than would either party to a binder contract. In a land contract, only the buyer would be interested in specifically enforcing the contract. If the buyer has performed according to the terms of the contract, he should be able to bring a successful action for specific performance.¹²¹

In summary, the Virginia Supreme Court will most likely uphold the contractual rights of the parties to a land contract. In a land contract, the seller retains title throughout the transaction and the parties establish the terms through bargaining. Since the seller retains title, he has a vendor's lien on the property until the purchase price is fully paid.¹²² If the land contract specifies that time is of the essence, courts will uphold a forfeiture for default in payment. The Virginia Supreme Court has recognized a waiver of default in a deed of trust case.¹²³ The trust creditor who has waived his claim of default is estopped from enforcing an acceleration clause.¹²⁴ In a land contract, therefore, it is highly likely that the court would find a waiver by the seller if he accepted any late payment from the buyer.

Virginia courts increasingly are faced with the question of how to treat land contracts. In recent cases,¹²⁵ courts struggling to determine the status of land contracts in Virginia have accepted the buyer's interest as paramount.¹²⁶ Even though the courts recognize that the seller retains legal title to the property, they do not regard mere retention of title as sufficient to support the seller's continued rights of ownership as against his mortgagee.¹²⁷ These recent decisions are likely to have a chilling effect on the use of land contracts as viable real estate financing alternatives.

The better course for Virginia to take is to incorporate the best of the theories from other jurisdictions to assure that land contracts continue to be used to fill the gaps in real estate financing. Without changing the nature of the instrument or the relationship of the parties, Virginia can still adopt policies to protect the buyer under a land contract without disadvantaging the seller. By requiring recordation of land contracts, Vir-

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¹¹⁹ See text accompanying note 110 *supra*.

¹²⁰ See *Barr v. MacGlothlin*, 176 Va. 474, 482, 11 S.E.2d 617, 620 (1940). The measure of damages in Virginia for breach of a binder contract is the difference between the contract price and the market value at the time of the breach. *Id.*

¹²¹ See note 117 *supra*.

¹²² See note 101 *supra*.

¹²³ *Fant v. Thomas*, 131 Va. 38 (1921).

¹²⁴ *Id.*

¹²⁵ See text accompanying notes 86-87 *supra*.

¹²⁶ *Accord*, *People v. Chicago Title & Trust Co.*, 75 Ill. 2d 479, 389 N.E.2d 540 (1979) (trustee in bankruptcy may reach land trust beneficiaries' interest in real property).

¹²⁷ See note 86 *supra*.

ginia could protect not only the buyer, but also subsequent grantees of an interest in the property. Without eliminating the seller's ultimate right to terminate the contract, Virginia law makers should establish a grace period within which the buyer can cure any default in payment. The seller's ownership should be upheld against challenges from his mortgagee, so long as the seller complies with his mortgage terms. If Virginia law makers essentially establish land contracts as "equitable mortgages" in which the mortgagee retains title, the seller would not lose his ability to foreclose and the buyer would not be denied recovery of his equity in the property in the event the parties did not perform under the contract.

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