

# National Law and Practice

---

2nd Edition

**Elizabeth (Liz) Bowen,**

MBA, MCNE, PSA, REDS, PMN, CMLXv, AHWD



**Real Estate College of Colorado, Inc.**

Material in this book is not intended to represent legal advice and should not be so construed. Readers should consult legal counsel for advice regarding points of law.

©2024 by Real Estate College of Colorado, Inc.

All rights reserved. No part of this book may be reproduced in any form by any means without the express written consent of the publisher.

## **PREFACE**

**National Law and Practice** is a modern learning tool for the student preparing to enter the real estate business. It is considered the core class in Real Estate Pre-License Training.

Understanding of terminology and theory of basic real estate practice is imperative for the successful completion of this course.

### **About the Author**

Elizabeth (Liz) Bowen has been a REALTOR® since 2004, specializing in residential real estate in Colorado Springs and all of El Paso County, Colorado. Her guiding principle has always been, "What's important to you is important to me." Understanding what her client's needs and wants are through a consultative approach, and then working diligently to help them accomplish their goals is her top priority.

As the Employing Broker/Owner of Red Bow Realty, she encourages her agents to be excellent stewards of their industry, make education a priority, and always put the client first. She is a Master Certified Negotiation Expert (MCNE), a Pricing Strategy Advisor (PSA) through the National Association of REALTORS®, and also a Real Estate Divorce Specialist, specifically trained to help divorcing people with the nuances of selling marital assets.

She is the 2023 President of the Colorado Women's Council of REALTORS® network, 2019 past-president of Women's Council of REALTORS® Pikes Peak Network, a Pikes Peak Association of REALTORS® REALTOR® Services Corp (RSC) Director and the owner of Liz Bowen Coaching.



# Table of Contents

<b>1. The Business of Real Estate</b> .....	<b>1</b>	<b>3. Real Estate Laws and Ethics</b> .....	<b>45</b>
The Real Estate Business .....	1	Federal Fair Housing Laws .....	46
Specialization .....	2	Protection for Disabled Tenants .....	49
Regulation .....	3	Exemptions .....	50
The Brokerage Business .....	4	Enforcement .....	51
Scope of Authority .....	6	Equal Credit Opportunity Act .....	52
Independent Contractor vs.		Americans with	
Employee .....	7	Disabilities Act (ADA) .....	52
What Brokerages Do .....	8	Advertising and Technology .....	54
Compensation .....	10	Antitrust Laws .....	54
Math – Calculating Commissions ...	12	Property Disclosure Laws .....	56
Chapter 1 Key Point Review .....	17	Environmental Issues	
Chapter 1 Review Questions .....	21	Requiring Disclosure .....	57
		Warranties .....	60
		Chapter 3 Key Point Review .....	61
		Chapter 3 Review Questions .....	67
<b>2. Working with the Public</b> .....	<b>25</b>		
Agency and Non-Agency			
Relationships .....	25	<b>4. Real versus Personal Property</b> .....	<b>71</b>
Common Law of Agency .....	26	What is Land? .....	71
Creation of Agency .....	28	Physical and Economic	
Agent’s Duties to Principals .....	29	Characteristics of Land .....	74
Primary Forms of Agency		Legal (Property) Descriptions .....	76
Relationships .....	31	Metes and Bounds .....	76
Subagency and Designated Agent .	32	Rectangular/Government Survey ..	79
Responsibilities of Agent to		Lot and Block (Recorded Plat) .....	84
Customers and Third Parties .....	33	Elevations .....	85
Termination of Agency .....	35	Math – Measuring Property .....	85
Non-Agency .....	35	Measuring Structures .....	85
Chapter 2 Key Point Review .....	37	Measuring Land .....	86
Chapter 2 Review Questions .....	41	Calculating Area .....	87
		Sidewalks .....	89
		Personal Property .....	90
		Defining Fixtures .....	91
		Chapter 4 Key Point Review .....	93
		Chapter 4 Review Questions .....	97

**5. Property Ownership ..... 101**

Real Estate versus Real Property..... 101  
Deeds ..... 102  
    Suffixes..... 103  
Ownership Rights ..... 106  
    Freehold Estates ..... 106  
Types of Ownership..... 109  
    Individual Ownership..... 109  
    Concurrent Ownership ..... 110  
Common Interest Ownership  
Properties..... 114  
Encumbrances..... 115  
    Liens..... 115  
    Easements and Encroachments... 118  
    Alienation..... 122  
Chapter 5 Key Point Review ..... 123  
Chapter 5 Review Questions ..... 131

**6. Land Use Controls and Regulations..... 135**

Government Rights in Land..... 135  
    Police Power ..... 136  
    Eminent Domain ..... 138  
    Taxation ..... 138  
    Math – Calculating Property Tax . 141  
    Escheat..... 145  
Other Government Controls ..... 145  
    Regulation of Environmental  
    Hazards ..... 146  
    Abatement, Mitigation  
    and Cleanup Requirements ..... 148  
Private Controls..... 149  
Chapter 6 Key Point Review ..... 151  
Chapter 6 Review Questions ..... 155

**7. Valuation and Market Analysis ..... 159**

Real Estate Market Economics ..... 159  
    Real Estate Supply and Demand .. 160  
    Other Economic Principles  
Appraisals ..... 166  
    Sales Comparison or  
    Market Data Approach..... 168  
    Adjusting the Comparables..... 170  
    Cost Approach or  
    Summation Approach ..... 171  
    Math – Calculating Appreciation  
    and Depreciation..... 173  
    Income Analysis Approach..... 176  
    Math – Calculating Income  
    Approach to Value ..... 178  
    Alternatives to the  
    Income Approach..... 181  
    What Happens Next ..... 183  
    Competitive/Comparable  
    Market Analysis..... 187  
Chapter 7 Key Point Review ..... 189  
Chapter 7 Review Questions ..... 195

**8. Financing ..... 199**

Basic Concepts and Terminology..... 200  
The Paperwork ..... 201  
Understanding Monthly  
Mortgage Payments ..... 204  
    Math – Interest Calculations..... 205  
    Reducing Loan Interest Rates  
    by Paying Points ..... 209  
Types of Loans ..... 210  
The Lending Process ..... 215  
Foreclosure and Short Sales ..... 221  
The Money Supply ..... 223  
Financing Laws and Rules ..... 225  
Chapter 8 Key Point Review ..... 229  
Chapter 8 Review Questions ..... 239

<b>9. Contract Law .....</b>	<b>245</b>
General. Contract Law Concepts .....	245
Types of Contracts .....	248
Purchase Agreement Offers and Counteroffers .....	249
Purchase Contracts .....	252
Listing/Buyer Representation Contracts .....	256
Different Types of Listing Contracts .....	256
Chapter 9 Key Point Review .....	259
Chapter 9 Review Questions .....	269

<b>10. Leasing and Property Management .....</b>	<b>275</b>
Basic Concepts / Duties of Property Management .....	275
Understanding Leases .....	278
Leasehold Estates .....	278
Lease Types .....	280
Key Lease Elements and Provisions .....	281
Landlord and Tenant Rights and Obligations .....	282
Leasing and the Law .....	284
Chapter 10 Key Point Review .....	287
Chapter 10 Review Questions .....	295

<b>11. Closing a Real Estate Transaction .....</b>	<b>299</b>
Escrow or Closing .....	299
RESPA / TRID / DISCLOSURES .....	301
Title Insurance .....	307
Trust/Escrow Accounts .....	316
Dollars and Cents .....	317
Math – Prorating Expenses .....	320
Income Taxes .....	323
Other Taxes .....	324
Chapter 11 Key Point Review .....	325
Chapter 11 Review Questions .....	331

<b>APPENDIX A. Answer Keys .....</b>	<b>335</b>
Chapter 1 .....	335
Chapter 2 .....	337
Chapter 3 .....	339
Chapter 4 .....	341
Chapter 5 .....	343
Chapter 6 .....	345
Chapter 7 .....	346
Chapter 8 .....	348
Chapter 9 .....	351
Chapter 10 .....	354
Chapter 11 .....	356

<b>APPENDIX B. Index .....</b>	<b>359</b>
--------------------------------	------------

<b>APPENDIX C. Chart of ee/or Words .....</b>	<b>364</b>
---	------------



# **1** The Business of Real Estate

**The Real Estate Business**

**The Brokerage Business**

**Math – Calculating Commissions**

---

## **The Real Estate Business**

---

Congratulations on making the decision to enter the amazing world of real estate. Real Estate offers many amazing career options; helping first-time home buyers with their first property purchase, helping commercial landlords find tenants, becoming an appraiser or helping investors pick the right property so they can make the profit they desire. The list goes on.

Your first stop for many of these opportunities is getting your real estate license. Many states require a specific amount of education, which is most likely why you're studying this material, as well as a criminal history background check and passing a timed examination.

As you may know, anyone can sell or buy, lease or find tenants on their own. Why would a member of the public hire a **licensee**, or someone with a real estate license? The short answer is because real estate licensees are trained professionals. For example, one day you're feeling under the weather. You go online and do a search on your symptoms. Many pages come up with different diagnoses. You could just pick one and hope it was

correct, but you know you're not qualified to do that. You need a trained professional, so you call your doctor and make an appointment.

A licensee's core **role** is to assist their clients in the accomplishment of their real estate goals while mitigating risk and operating within the law. They act as a buffer, protecting their client's confidential information and contributing their knowledge and expertise to guide that person to a successfully closed transaction.

Once you have earned a real estate license, your educational journey doesn't stop. Licensees may need to take additional classes every year, called **continuing education**. The best real estate licensees hone a variety of skills and constantly improve their industry and market knowledge in areas like local market conditions, real estate principles, real estate law, value estimation, real estate financing, investment principles, license law, real estate math calculations and closing procedures. Basically, it takes ongoing training and education to remain competent to practice real estate.

In addition, licensees need to know how to market themselves and the properties they're representing on behalf of sellers. They must understand liability and data management, time management, be effective communicators, have decent writing skills and know how to use a computer.

## ***Specialization***

Many licensees choose to specialize in a type of property transaction. **Specialization** allows licensees to differentiate themselves from others and become valuable resources to clients looking for the skills a specialist provides. Each area of specialization may require additional classes to ensure competency. The following are different property type specializations licensees could choose from:

- **Residential** – single-family homes, duplexes, triplexes and/or fourplexes
- **Commercial** – shopping malls or office buildings
- **Industrial** - warehouses
- **Investment** – secondary properties purchased to sell for profit or keep as rentals

- **Farm and Ranch** – homes on acreage, usually with wells and septic systems
- **Land** – vacant land
- **Special Purpose** – religious buildings or movie theaters

Additionally, licensees may specialize or choose to help clients based on any of the following:

- **Geographical Area** – mountain properties, downtown lofts, or certain communities
- **Type of Transaction** – sales, leases, exchanges or options
- **Type of Client** – buyers or sellers, landlords or tenants, even military or seniors
- **Type of Relationship** - agency, neutrality, etc.

## ***Regulation***

The real estate industry is **regulated** at every governmental level - federal, state and local municipality. This requires licensees to understand **federal fair housing law, state licensing law** and **county zoning classifications**. License laws in each state specify who must obtain a license to practice real estate and set the requirements for obtaining a license. License law also establishes procedures for handling escrow deposits and fees, for advertising, and provide guidelines for dealing with clients and customers.

Additionally, licensees can elect or may be required to belong to **trade organizations** such as the National Association of REALTORS®, The Appraisal Institute, American Society of Home Inspectors, National Association of Home Builders and Women’s Council of REALTORS®. As an example, the National Association of REALTORS® produces a Code of Ethics that its members choose to follow. It reflects common license law as well as instructions on how to conduct oneself and one’s real estate business in a highly ethical manner.

---

## The Brokerage Business

---

The business of real estate begins at the **brokerage firm** or real estate company. Generally, each real estate company has an **owner** or owners, who may or may not be licensed to sell real estate. The licensed person in charge of the brokerage firm is known as the **broker** (also known as the employing broker or responsible broker). Those with a real estate license who are hired to work for the broker/brokerage firm are often called **salespeople** or licensees. There may also be licensed or unlicensed assistants and unlicensed support staff.

A real estate license allows a broker and licensees the ability to broker or facilitate all types of real estate transactions for a fee, although it is common to specialize. For example, the brokerage firm may only perform property management services or specialize in commercial transactions. A licensed salesperson may only work for one employing broker at a time per state. So, if a licensee wants to help buyers and sellers with residential real estate transactions as well as help commercial landlords acquire and keep tenants, the licensee will need to find one brokerage firm that allows and offers all of these services; she could not work for a residential real estate broker at one company and a commercial real estate broker at a different company in the same state.

Brokerage firms can be established as one of several different types of business entities (NOTE: Some of the following business entities are not allowed to broker real estate).



- **Sole Proprietorship:** This business type is owned by a single individual. When the proprietor dies, the business terminates. Sole proprietors are personally liable for their own debts and actions as well as those of employees while performing business duties; proprietors may be sued personally. Business profits are taxed once as the proprietor's personal income.
- **Corporation (for Profit):** Corporations are owned by stockholders. A board of directors elected by stockholders oversees the business. Corporations never die and have a “perpetual” existence; they survive the death of any of the stockholders. Shareholders of the corporation are only liable to the extent of the value of one's shares; officers and directors may be held personally liable for the corporation's actions. Corporation owners are double taxed on business profits, i.e., corporate profits are taxed, and after-tax dividends distributed to shareholders are taxed again as personal income.
- **Corporation (Not for Profit):** A not-for-profit business distributes the profit it makes not to its business owners but in a way that fulfills its organizational objectives. Not-for-profit organizations are commonly clubs or associations and do not qualify for tax-exempt status in the US (Thakur, 2021). A non-profit corporation is a corporate entity that is not legally entitled to generate profit. A board of directors and officers manage operations. *Non-profit organizations are not subject to taxation and cannot broker real estate.*
- **General Partnership:** This describes a for-profit business consisting of two or more co-owners who have agreed to share business profits. Unlike a corporation, the general partnership is not a distinct, legal entity, although a corporation may be a partner in a general partnership. General partnerships are created by a written or oral partnership agreement. The partnership may be terminated through mutual agreement, withdrawal or death of a partner, or by legal action. All partners bear full liability for debts and obligations. Partners are taxed once on their respective partnership profits.
- **Limited Partnership:** This organization consists of both general partners and limited partners. General partners are wholly responsible for business operations, while limited partners are investors who participate only in business profits. The general partners typically receive compensation for their management responsibilities. A limited partner must make an investment, which subsequently comprises the extent of the

partner's liability. Therefore, if a limited partner makes an initial investment of \$10,000, he is only liable for \$10,000 in business debts. Limited partners are taxed once, on profits distributed by the partnership. General partners bear sole liability for debts and obligations.

- **Joint Venture:** A joint venture is a partnership formed to complete a specific business endeavor, such as a real estate development. Individuals, general and limited partnerships, and corporations may participate. In forming the entity, the partners identify how they will conduct business and share profits. Principal parties in the joint venture share liability but may not obligate the other co-venturers to agreements outside of the joint venture project.

- **Business Trust / Real Estate Investment Trust:** A business trust is a group of investors who invest in a pooled trust fund managed by their elected trustee. The trustee purchases investment assets and distributes profits and gains to the trustors. A business trust that invests primarily in real estate and meets certain other requirements is a real estate investment trust (REIT) and receives special tax treatment. A business trust cannot broker real estate, but it may buy and sell its own real estate assets.

An entity that is legally allowed to broker real estate can be either an **independent** firm or **affiliated** with a national franchise. They can specialize in a type of property (commercial only), type of transaction (real estate options), or a type of client (Seller Agency only). These variations in brokerage organization are usually a response to competitive conditions in the local real estate market.

## *Scope of Authority*

Most state laws provide for two distinct licenses to conduct real estate brokerage: a broker's license and a salesperson's license. A licensed real estate broker is duly authorized to represent clients directly in brokering real estate by the state that has issued their real estate license. A licensed salesperson, on the other hand, is only authorized to represent a broker and carry out such duties as the broker may legitimately delegate to them. A salesperson is therefore a **fiduciary** of the employing broker and must act entirely on the broker's behalf as either a **subagent** or a **designated agent**.

The nature of a real estate salesperson's relationship with a principal employing broker is determined by mutual agreement. The actual form of the employment contract between a brokerage and employed licensees depends on whether the licensee is to operate as the broker's **employee** or as an employed **independent contractor**.

## *Independent Contractor versus Employee*

A salesperson may be an independent contractor (IC) or an employee for tax purposes. In either case, the employing or responsible broker provides supervision and is liable for the salesperson's actions. Most real estate licensees are affiliated with their brokers as employed independent contractors.

Generally, a broker has limited control over an independent contractor's actions. Specifically, a broker can require performance results, but is



limited in demanding how a contractor performs the work. For example, a broker may not mandate selling methods, meeting attendance, or office hours. An IC is responsible for his or her own income and social security taxes; the broker does not withhold taxes. A broker cannot provide an IC with employee benefits such as health insurance or pension plans. A principal broker could be held liable for the acts of his or her independent contractor(s). A broker would owe an independent contractor a

written IC agreement and compensation based on production but not business cards, leads, yard signs, etc. This broker is sometimes referred to as an **employing broker**.

A broker has greater control over the actions of an employee. A broker can impose a sales methodology, such as requiring all employees use a specific listing presentation document or script. In addition, a broker can enforce all office policies, including hours, meeting attendance, and telephone coverage. A broker must withhold income taxes and pay

unemployment compensation tax on behalf of an employee. An employee may receive the benefits enjoyed by the broker's non-selling employees. This broker is sometimes referred to as an **employer broker**.

Brokers have responsibilities to train and supervise associated licensees and employees. Licensees as employees could be required to go through training classes and become familiar with policy and procedures manuals. Licensees as independent contractors can be invited to attend training classes and to become familiar with policy and procedure manuals, but the broker has no control over what they choose to do.

In placing one's license with a brokerage firm as either an independent contractor or employee, salespeople generally make a commitment to work diligently to sell the broker's listings and procure new ones. They promote the reputation of the broker's business and abide by the broker's established policies. Salespeople fulfill the fiduciary duties owed to clients (as their subagent) and maintain required insurance policies. They have transportation for conducting business, as required by the broker; conform to ethical standards imposed by the broker and/or trade organizations the broker (and subsequently they) belong to; and uphold all covenants and provisions of the employment agreement.

A broker also makes a commitment to the salespeople they employ. The broker will make the brokerage's listings available and make the brokerage's market and property data available. The broker will provide whatever training was promised at the time of hiring, along with whatever office support may have been discussed. The firm will commit to a commission structure and possibly an expense reimbursement policy, conform to ethical standards imposed by the broker's trade organization, and uphold all covenants and provisions of the employment agreement.

## ***What Brokerages Do***

1. **Obtain a client listing** – this is an employment contract between the broker and the client. Generally speaking, the steps involved are:

- a) *Prospecting for clients*
  - b) *Determining the market price for a client's property*
  - c) *Delivering a listing presentation, which explains why the client should hire the brokerage firm. This usually includes how the property will be marketed.*
  - d) *Negotiating the listing agreement/contract*
2. **Market a listing** – once hired, the salesperson on behalf of the broker implements a detailed plan to expose the client/client's property to the greatest number of potential properties or buyers.
  3. **Facilitate the closing of a transaction** – the salesperson's expertise and knowledge guide the client through the many pre-closing activities involved in a successful transaction.
  4. **Manage market information** – the salesperson's expertise includes understanding the current state of the housing industry in the geographical area in which he or she serves clients, a.k.a. their market.

Unsurprisingly, there are regulations that govern how a property can be marketed. In general, state laws and regulations require that advertising must not be misleading. In addition, the broker is responsible for the content of advertising done by licensees.

All **advertising** must reveal the identity of the broker/brokerage firm; licensees may not use blind ads that conceal their firm's identity, nor can they advertise in their own name solely unless selling their own property through channels outside of their firm, like as a For Sale by Owner seller. Licensees selling their own property through the brokerage firm must disclose their brokerage firm's identity.

As mentioned previously, one doesn't need to have a real estate license to sell one's own home. A real estate license is required to help others sell or lease their home or help buyers purchase or rent a home *for a fee*. It's the latter that is considered **brokerage services**. Purchasing or selling real estate for oneself is sometimes considered **trading**.

In addition, there's a difference between brokerage services and **advisory services**, or those activities that are not tied to a specific transaction and would not be considered brokerage services. For example, helping a

buyer or seller in a property transaction for a fee is a brokerage service. Providing an estimate of value for a potential seller is a brokerage service, but to do so for a bank that has not hired the brokerage firm would be considered an advisory service. The same goes for performing a market analysis. Managing property could be either brokerage or advisory depending on the state.

The critical difference between selling a business and selling real estate is that selling a business includes the transfer of business income, personal property assets and possibly liabilities, and potentially real property. A real estate license is required to sell a business if any portion of the business asset includes a real property interest, be it ownership or a lease.

If stocks are included in the business assets to be sold, the person assisting with the sale might need to hold a **securities license** as well as a real estate license to assist in the transfer of those assets.

Residential licensees provide the following services on behalf of the brokerage firm:

- Locating a buyer for a seller
- Locating a seller for a buyer
- Locating a tenant for a landlord
- Locating a landlord for a tenant

A salesperson may not **bind** a client to any contract (i.e., sign the client's name), receive compensation directly from a client, or accept a listing or deposit that is not in the name of the brokerage firm.

## ***Compensation***

A salesperson who is an employee may receive wages, salary, additional commissions, expense reimbursements, and benefit plans. An independent contractor's compensation is normally a combination of **commissions** and free office support.

Most salespeople work as independent contractors who are paid a commission upon the successful closing of a real estate transaction; they are not paid a salary. A licensee's compensation can vary widely from company to company. The brokerage firm usually sets a compensation policy that salespeople accept when they agree to place their license with that brokerage firm, however the broker and the salesperson may negotiate that policy. A salesperson earns compensation for procuring listings and for procuring buyers or tenants; they are paid whenever a transaction results and successfully closes.

There are two sides to every transaction – the **listing** side (seller) and the **sales** side (buyer). In most cases two different brokerage firms will represent the buyer and the seller or the landlord and tenant in a real estate transaction. Brokerage **cooperation** refers to this scenario where, for example, a licensee for ABC Realty Company secures a seller and a different licensee at 123 Real Estate Company has secured a buyer, and that buyer wants to purchase the seller's property.

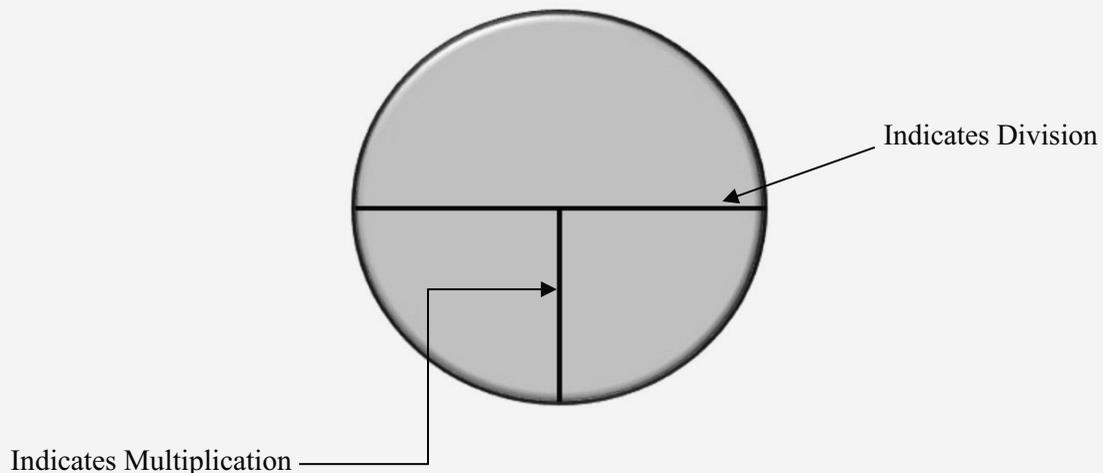
Unlike other countries, in the United States the **listing** brokerage firm (working with the seller) usually shares its negotiated commission with the **selling** brokerage firm (working with the buyer) as directed by the seller. This may be a 50/50 split (though it does not have to be) of the listing firm's negotiated commission from the seller; both the listing commission and the amount to be shared with the brokerage firm that brings the buyer are documented in a listing contract. All commissions are earned by the brokerage firm. A salesperson is not allowed to receive commissions directly from the buyers and sellers they assist. Commissions for brokerage services are paid directly to the broker (brokerage firm) and are then paid to the salesperson based on their compensation agreement with their broker.

Brokerage firms usually market their sellers' properties through a Multiple Listing Service or **MLS**. This online repository of homes for sale is created in cooperation between brokerage firms and includes any offer of compensation to a licensee with an agency or neutrality relationship with a buyer. An MLS may be configured to push information out to other websites, making listing data available to the public.

Calculating how much money a salesperson will earn (commission dollars) upon the successful closing of a transaction is a multi-step process. Usually, the first step is determining how much **gross commission income** will be generated based on the commission negotiated between the salesperson (on behalf of the brokerage firm) and the seller client. Next, the listing commission will be shared with the cooperating brokerage firm whose licensee “procured” or brought a ready, willing and able buyer who successfully purchased the home (completed the real estate transaction) based off a pre-determined percentage usually offered through the MLS. Lastly, it will be determined what percentage/dollar amount of the earned funds will be paid by the brokerage firm to the salesperson based on their agreed-to employment contract.

### Math- Calculating Commissions

Throughout this text, we will present the formulas to calculate many real estate math problems using a technique called a “circle formula.” The center horizontal line represents a division calculation, and the smaller vertical line indicates when to multiply.



Commonly, math problems on the state exam will present you with two of the three components of a formula and you need to solve for the missing or third piece. Your job is to memorize the formulas (as circle formulas if you wish) and apply them to the problem at hand. Once you plug in the information provided to you in the question, you can “cover up” what you don’t know on the circle and what’s left is the formula to follow.

Let's apply this to our commission scenario. The formula is:

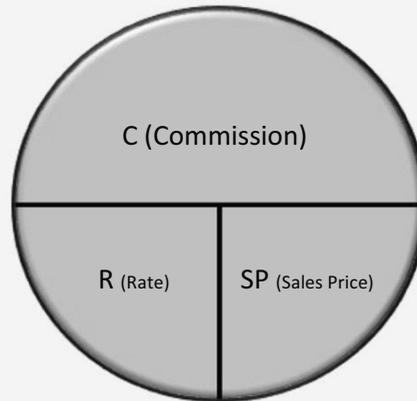
$$\text{Sales Price} \times (\text{Commission}) \text{ Rate} = \text{Commission Dollars}$$

Using an acronym for this formula, we call it the CRiSP formula.

**C = Commission**

**R = Rate**

**SP = Sales Price**



### ***Commission Scenario:***

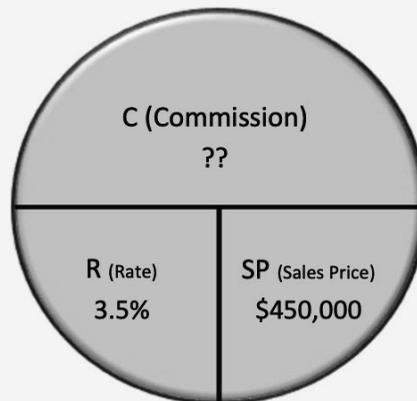
- On the east side of town, James works as an independent contractor for ABC Realty. His employment agreement says that of the commissions he earns on behalf of ABC Realty, he receives 70% and the brokerage firm keeps 30%.
- James secured a listing contract for his brokerage firm with Sally Seller. All licensees at ABC Realty are instructed to negotiate for a commission of 7% of the sales price, due at the successful culmination of the transaction. Sally agrees to these terms.
- Of the 7% negotiated commission, Sally instructs James to share half with the brokerage firm that brings a ready, willing, and able buyer who successfully completes the real estate transaction, thus buying her home.
- On the north side of town, Mary works as an independent contractor for 123 Real Estate. Her employment agreement says that of the commissions she earns on behalf of 123 Real Estate, she receives 80% and the brokerage firm keeps 20%. Mary also pays a fee of \$200 per transaction.
- Salesperson Mary has secured an agreement with Bob Buyer on behalf of 123 Real Estate to help him purchase a home.
- Sally Seller and Bob Buyer enter into a purchase agreement with a negotiated purchase price of \$450,000.

**Question 1 – How much will James earn when the transaction closes?**

**Step 1** – Calculate the commission earned by the listing brokerage firm.

ABC Realty's net commission percentage in this situation is 3.5% (7% - 3.5% to a cooperating brokerage firm.)

Draw the Circle Formula and place the information that you know in the Appropriate parts of the formula.



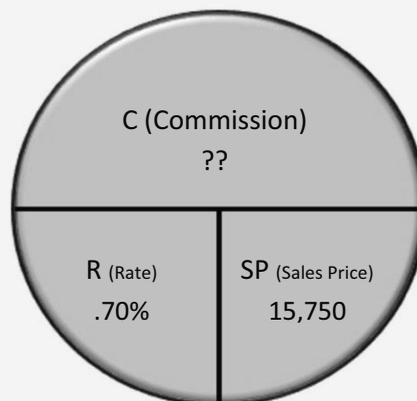
The formula visually instructs you to multiple the Rate x Sales Price.

$$3.5\% (.035) \times \$450,000 = \$15,750.$$

**Step 2** – Calculate the commission James will be paid by his brokerage firm.

James earns 70% of the brokerage commission.

Draw the Circle Formula and place the information known into the formula. Use Brokerage Commission in lieu of Sales Price.



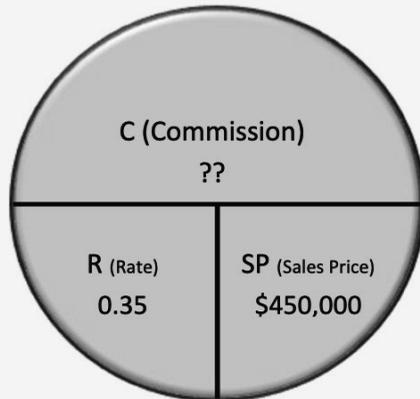
$$70\% (.70) \times \$15,750 = \$11,025.$$

**Question 2 – How much will Mary earn when the transaction closes?**

**Step 1** – Calculate the commission earned by the selling brokerage firm.

123 Real Estate’s net commission percentage in this situation is the same as ABC Realty 3.5% of the sales price.

Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.



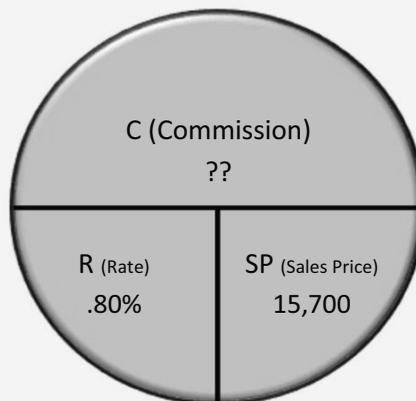
The formula visually instructs you to multiple the Rate x Sales Price.

$$3.5\% (.035) \times \$450,000 = \$15,750.$$

**Step 2** – Calculate the commission Mary will be paid by her brokerage firm.

Mary earns 80% of the brokerage commission less a transaction fee of \$200.

Draw the Circle Formula and place the information known into the formula. Use Brokerage Commission in lieu of Sales Price.



$$80\% (.80) \times \$15,750 = \$12,600 - \$200 \text{ (transaction fee)} = \$12,400.$$



# Chapter 1 Key Point Review

---

1. The Real Estate Business
  - a. Offers many career options.
  - b. First step is to obtain a real estate license.
2. A licensee's role is to assist their clients while mitigating risk and operating within the law.
3. Licensees will need to take additional continuing education classes to remain licensed.
4. Many licensees choose to specialize in a type of transaction such as Residential, Commercial, Industrial, Investment, Farm and Ranch, Land, Special Purpose.
5. Licensees may also specialize by geographical area, type of transaction, type of client, or type of relationship.
6. Regulation
  - a. Real Estate is regulated at every level – federal, state and local.
  - b. License laws in each state specify who must obtain a license to practice real estate and setting requirements for obtaining a license.
7. The Brokerage Business
  - a. Each real estate company has:
    - i. An owner or owners. Not necessarily licensed.
    - ii. A broker (also known as the employing broker or responsible broker).
    - iii. Salespeople (licensees) hired to work for the broker.
    - iv. Licensed or unlicensed assistants and support staff.
  - b. A real estate license allows a broker and licensees the ability to broker or facilitate all types of real estate transactions for a fee.
  - c. A licensed salesperson may only work for one employing broker at a time per state.
  - d. Brokerage Firms may be established as:
    - i. Sole Proprietorship
      1. Owned by a single individual, business ends when the owner dies.

- ii. Corporation (For Profit)
  - 1. Owned by stockholders, board of directors oversees the business.
  - 2. Corporations never die and have perpetual existence.
  - 3. Corporations survive the death of any stockholder.
- iii. Corporation (Not for Profit)
  - 1. Distributes profits to fulfill its organizational objectives, not to the “business” owners.
  - 2. Not subject to taxation.
  - 3. CANNOT BROKER REAL ESTATE.
- iv. General Partnership
  - 1. Consists of two or more co-owners, created by a partnership agreement.
  - 2. May be terminated through mutual agreement, withdrawal, death of a partner or by legal action.
  - 3. All partners bear full liability for debts and obligations.
- v. Limited Partnership
  - 1. Consists of both general partners and limited partners.
  - 2. General partners wholly responsible for business operations, debts and obligations.
  - 3. Limited partners are investors who participate only in investor profits.
- vi. Joint Venture
  - 1. A partnership formed to complete a specific business endeavor.
  - 2. Used commonly for real estate development.
  - 3. Principal parties in the joint venture share liability but may not obligate the other co-venturers to agreements outside of the joint venture project.
- vii. Business Trust / REIT
  - 1. Group of investors who invest in a pooled trust fund.
  - 2. A business trust that primarily invests in real estate is known as a Real Estate Investment Trust (REIT)
  - 3. CANNOT BROKER REAL ESTATE.

e. Brokerage firms can be either independent or affiliated with a franchise.

8. Most state laws allow for two distinct licenses to sell real estate.

- a. Broker (Employing Broker) – authorized by the state to represent clients.
- b. Salesperson (Associate Broker) – authorized to represent a broker and carry out duties delegated to them by the Broker.
  - i. Considered a fiduciary of the Employing Broker.
  - ii. Acts as a subagent or designated agent of the Broker.

9. A salesperson relationship with their Broker will be one of two ways:

- a. Independent Contractor
  - i. Broker has limited control over the independent contractor's actions.
  - ii. Can require performance results but cannot dictate how a contractor performs their work or require specific times or hours of work.
  - iii. Independent Contractor is responsible for their own taxes, Broker will not withhold.
- b. Employee
  - i. Broker can impose a sales methodology, policies, hours, attendance, etc.
  - ii. Broker must withhold taxes and unemployment compensation.

10. Responsibilities between Brokers and Salespeople

- a. Brokers have responsibilities to supervise licensees and employees.
- b. Salespeople make a commitment to work diligently to sell the broker's listings and promote the reputation of the broker and abide by their policies.
- c. The broker makes the brokerage's listings available to their salespeople.

11. Advertising

- a. National and State regulations govern how property can be marketed.
- b. Advertising must not be misleading. |
- c. All advertising must reveal the identity of the broker/brokerage firm.
  - i. Licensees may sell their own property without using the brokerages name if they use channels outside their firm (For Sale By Owner).
  - ii. If they sell through the brokerage firm, they must disclose the brokerage firm's identity.

12. Services

- a. Brokerage Services
  - i. Helping others sell, lease, buy or rent a home for a fee.
  - ii. Providing an estimate of value for a potential seller.
- b. Advisory Services
  - i. Providing an estimate of value (Broker Price Opinion) for a bank.

- c. Selling a business would require a real estate license if any real property interest (leasehold or ownership) is transferred with the sale.
    - i. Sale of stock in a business would require a securities license.
- 13. A salesperson may not bind a client to any contract (i.e. sign the client's name, receive compensation directly from a client, or accept a listing or deposit that is not in the name of the brokerage firm).

#### 14. Compensation

- a. Most salespeople earn a commission not a salary.
- b. Compensation can vary widely from company to company.
- c. Compensation is negotiable between the broker and the salesperson.
- d. Paid when a transaction successfully closes.
- e. Two sides to every transaction.
  - i. Listing side (with the seller).
  - ii. Selling side (with the buyer).
- f. Brokerage cooperation refers to the agreement between two brokerages as to how compensation will be split between brokerages in a successful sale.
- g. All commissions earned by the broker/brokerage firm.
- h. A salesperson is only allowed to receive compensation from their broker.

# Chapter 1 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. A licensed non-profit corporation can be a real estate brokerage firm.
2. A licensed salesperson may only work for one employing broker at a time in any given state.
3. A salesperson is allowed to be paid by either the principal or their employing broker.
4. A property for sale may be advertised so long as the salesperson's name is in the advertisement.
5. If a broker employer hires a salesperson as an employee, the broker employer must withhold income and social security taxes from the salesperson's income.
6. If a broker hires a salesperson as an independent contractor, the broker must withhold income and social security taxes from the salesperson's income.
7. An employing broker is allowed to require an independent contractor salesperson to hold specific office hours or attend mandatory sales meetings.
8. An employing broker could be held liable for the actions of the salesperson.
9. An independent contractor salesperson must have a written independent contractor agreement with the employing broker.
10. A partnership and/or corporation is allowed to have a real estate license.
11. Many states require a specific amount of education before issuing a real estate license.
12. The public can't sell or buy, lease or find tenants on their own; they have to hire a licensed real estate professional.
13. Licensee's core role is to assist their clients in the accomplishment of their real estate goals while mitigating risk and operating within the law.
14. Once a real estate license is issued, there are no further educational requirements to keep that license active.
15. Most licensees do not choose to specialize and will handle commercial, residential and property management transactions.

16. Residential real estate covers single-family homes, duplexes, triplexes and/or fourplexes.
17. Licensees do not usually specialize in a geographical area as their license covers their entire state.
18. Real estate is a heavily regulated industry.
19. Licensees do not have to understand county zoning classifications.
20. Real estate licensees act as a buffer, protecting their client's confidential information.
21. There are no real estate trade associations.
22. All real estate brokerage owners must be licensed.
23. The employing broker or responsible broker must be licensed.
24. A licensee can only have an active license in one state.
25. A limited partnership can only be comprised of limited partners.
26. A limited partner is only liable up to the amount of their initial investment.
27. A real estate investment trust or REIT pools its money and buys real estate assets.
28. A business trust can't broker real estate.
29. All brokerage firms are affiliated with a national franchise.
30. Only the employing broker has a real estate license.
31. Locating a buyer for a seller is one of the services that a residential licensee offers on behalf of the brokerage firm.
32. It's perfectly acceptable for a salesperson to sign a contract on behalf of their client.
33. A broker would owe an independent contractor a written IC agreement and compensation based on production, but not business cards, leads, yard signs, etc.
34. A broker cannot provide an IC with employee benefits such as health insurance.
35. A broker cannot provide an employee with employee benefits such as health insurance.

36. Brokers have no responsibilities towards their licensees.
37. Licensees can locate a landlord for a tenant client.
38. The broker will provide whatever training was promised at the time of hiring, along with whatever office support may have been discussed.
39. The brokerage firm doesn't have to commit to a commission structure for licensees.
40. Licensees don't market listings, only the brokerage firm markets listings.
41. A salesperson should understand the current state of the housing industry in their area.
42. Licensees selling their own property through the brokerage firm do not need to disclose their brokerage firm's identity.
43. Purchasing or selling real estate for oneself is sometimes considered trading.
44. Helping a buyer or seller in a property transaction for a fee is an example of a brokerage service.
45. Providing an estimate of value for a potential seller is a brokerage service.
46. Providing an estimate of value for a bank that has not hired the brokerage firm would be considered a brokerage service.
47. One must have a real estate license to sell a business opportunity.
48. A real estate license is required to sell a business if any portion of the business asset includes a real property interest, be it ownership or a lease.
49. If the business interest has stock as part of the assets that are being sold, it might be necessary to hold a securities license as well as a real estate license.
50. Most independent contractors earn their compensation monthly.
51. An independent contractor's compensation is normally a combination of commissions and free office support.
52. There are three sides to every transaction – the listing side, the selling side and the brokerage side.

53. In most situations, licensees at the same brokerage firm represent the seller and the buyer in the same transaction.
54. Brokerage cooperation refers to two different brokerage firms working for different clients in a real estate transaction.
55. The listing brokerage firm (working with the seller) shares its negotiated commission with the selling brokerage firm (working with the buyer).
56. The listing brokerage firm (working with the seller) never shares its negotiated commission with another brokerage firm. The selling brokerage firm can only be compensated by the buyer.
57. The selling brokerage firm works with the seller.
58. The listing brokerage firm negotiates a commission with the seller.
59. The MSL or Multiple Listing Services is a place for licensees to find brokerage firms looking to hire employees or independent contractors.
60. To calculate the commission earned by a licensee, first calculate the gross commission income generated through negotiations with the client.
61. All commissions are earned by the brokerage firm.
62. Commissions earned by the brokerage firm are paid to the salesperson based on the multiple listing service.
63. Commission earned by the brokerage firm are paid to the salesperson based on the Independent Contractor agreement.
64. The first calculation when determining commission owed is to take the sales price and multiply that by the commission rate negotiated with the client.
65. All licensees at 123 Realty are instructed to negotiate for a commission of 6% of the sales price, due at the successful culmination of the transaction. Of that 6%, the seller wants 2.85% to go to the licensee working with the buyer. If the house sells for \$550,000, the gross commission income for the selling brokerage firm is \$17,325.
66. Quinn's IC agreement with 123 Realty states that she earns 80% of the commissions on her closed transactions. If her listing sells for \$425,000 and her company earns 3.5% at closing, her check from her brokerage firm will be \$11,900.

# 2

## Working with the Public

### Agency and Non-Agency Relationships

---

#### Agency and Non-Agency Relationships

---

If you were to walk up to anyone on the street and ask, “What do you call the person you hire to sell your house?” you’d undoubtedly get one or two different responses. The first may be “a **REALTOR®**.” The second would probably be “an **agent**.”

What’s interesting here is that neither REALTOR® nor agent are generic terms for a real estate professional. A REALTOR® is a real estate licensee who belongs to a local association or board of REALTORS®, and by extension a state association and the National Association of REALTORS®. Not everyone with a license belongs to a board of REALTORS®. The term “agent,” while ubiquitous, also holds a very specific meaning with very specific rules.

The most appropriate term in answer to the above question is “licensee,” although “broker” or “salesperson” would be good alternatives, depending on the state where the license is issued.

## *Common Law of Agency*

The **common law of agency**, which exists in every state in the country, sets up fiduciary obligations for all agents, regardless of industry. In the context of real estate, agency refers to the nature of the relationship between the real estate licensee and the parties to whom brokerage services are provided.

Traditional agency involves a principal and an agent. Under an agency agreement, the **principal** is the client for whom the agent has agreed to provide a service. In residential real estate, this is typically



assistance in a transaction such as the purchase or sale of a home. The principal, or **client**, agrees to cooperate with the agent, potentially compensate the agent, and not to hinder the agent's ability to provide services. The **agent** in this situation would be the brokerage firm. It should be stated that an agency relationship is not established by who pays the compensation to the brokerage. It is entirely possible for a licensee to have an agency relationship with their client but be compensated by the other party to the transaction. (i.e. A Buyer's Agency relationship where the licensee is directed by their buyer client to receive compensation from the seller and listing brokerage firm.)

A **customer** is a person not under an agency agreement. This person is often called unrepresented because there is no representation agreement between him or her and the brokerage firm. For example, you are working with a buyer and have been hired to act as an agent. You find the perfect house that the seller is marketing himself (for sale by owner). The seller is willing to work with you because you have brought him a buyer, however you have no relationship with this seller; he is a customer.

Common law of agency defines three types of agency, which vary based on the level of authority (actions that can be taken) that the principal allows.

- **Special (Limited) Agent** - Authorized to represent the principal in a transaction to perform one function, such as “find me a ready, willing, and able buyer.” Special agents are not authorized to bind their principal, which means they can’t sign a contract on the client’s behalf. Once the task is complete, the agency relationship terminates.
  - A real estate brokerage with a listing contract is typically considered a special agent.
- **General Agent** - Authorized by a principal to represent that party’s interests in a specific range of matters (i.e., financial, medical, etc.). General agents have a limited ability to bind their principal.
  - Property managers are usually general agents authorized to represent the principal (landlord) in all matters concerning one area of the principal’s interests, usually to include finding quality tenants, maintaining the property, and providing financial reports.
  - Salespeople are often general agents for their brokerage firm (principal), as their job is to secure listing contracts with buyers and sellers. In this capacity, they have permission to bind their brokerage firm to a client.
- **Universal Agent** - Authorized to represent the principal with virtually unlimited authority. Most states permit someone with a **Power of Attorney** (written specific authority) to sign legal documents for someone else. The person with a signed and notarized Power of Attorney is called an **attorney-in-fact**. He or she has written authority to execute (sign) one or more legal instruments for another person. The Power of Attorney document must usually be recorded in the county where the property is located; this is called the Equal Dignities rule.
  - Real estate agents do *not* act in this capacity.
  - Special Power of Attorney would be created only for a specific act or acts. For example, a real estate power of

attorney would allow a family member to only sign real estate documents on behalf of a seller or buyer.

- General Power of Attorney provides authority to carry out all of the business dealings of the person giving it. If someone were to be deployed overseas, that person's spouse may have a general power of attorney that allows for handling real estate, banking, medical situations and making other legal decisions.

## *Creation of Agency*

Agency relationships may be expressed or implied. **Express agency** is a relationship created verbally or in writing by a formal agreement or contract. The **Statute of Frauds** may require the agency agreement to be in writing to be enforceable in court.

A written listing contract between a seller and a broker is an example of express agency; the seller is authorizing the brokerage to find a buyer for his or her property. A written buyer representation contract would also be an example of express agency as it allows a buyer to authorize the brokerage firm to find a property that meets his or her needs and, typically, to negotiate on behalf of the buyer in that transaction.



The **implied agency** relationship may be created when, either intentionally or inadvertently, one's actions indicate they have mutually consented to an agency relationship. There is no written (express) agreement.

Imagine you are a licensee and have gone out to a restaurant with your friends. Gary, who knows you are in real estate, asks you about the market and how much you think he could get for his house. He explains that he's recently updated his kitchen. Since you've been in Gary's house and know his neighborhood, you tell him that you think his house could sell for \$425,000. You also tell him that you have several buyers looking

in that price range and ask if you could come by and check out the work he's done. He agrees.

The next day, you send out an email to all of the people in your database about Gary's house and encourage anyone who may be interested to give you a call to set up a showing. One of your past clients reaches out to you and you contact Gary and set up a time to show his house.

By acting like an agent – even without a written contract – you have created an implied agency relationship. If Gary assumes you are his agent and you don't fulfil your obligations to him, you could be held liable.

## *Agent's Duties to Principals*

Under the common law of agency, the brokerage owes a **fiduciary** duty to the principal. Fiduciary is a common law term that describes a relationship of trust and confidence between a principal and an agent. Fiduciary obligations typically involve putting the client's interests above the agents.

### *A Helpful Trick: OLDCAR*



An agent's fiduciary duties to the principal are easily remembered using the acronym "**OLDCAR**," which stands for: **Obedience, Loyalty, Disclosure (Full), Confidentiality, Accounting, and Reasonable Skill and Care.**

#### Obedience

An agent must comply with the client's directions and instructions, provided they are legal. An agent who cannot obey a **legal directive**, for whatever reason, must withdraw from the relationship. If the directive is illegal, the agent must also immediately withdraw.

#### Loyalty

The agent must place the interests of the client above all other, including the agent's own.

Disclosure	<p>An agent has the duty to inform the client of all <b>material facts</b>, reports, and rumors that might affect the client's interests in the property transaction. Most states now require the disclosure of <b>adverse material facts</b> to all parties. Adverse material facts are generally defined as a fact that, if known, would affect a buyer's opinions or actions.</p>
------------	--

Confidentiality	<p>An agent must hold in confidence any personal or business information received from the client. An agent may not disclose any information that would harm the client's interests or bargaining position, or anything else the client wants to keep secret. Specifically, the client's <b>motivating factors</b> (why they want to sell, or that they'd accept less than their asking price or different financing terms than what they've stated) must be kept confidential.</p> <p><i>Confidentiality is one of the duties that extends beyond the termination of an agency agreement. At no time in the future may the agent disclose confidential information.</i></p>
-----------------	--

Accounting	<p>An agent must safeguard and account for all monies, documents, and other property (think keys or garage door remote controls) received from a client or customer. State license laws will regulate the agent's accounting obligations and escrow practices.</p>
------------	--

Reasonable Skill and Care	<p>The agent is hired to do a job and is therefore expected to do it with diligence and reasonable skill and care comparable to that of other real estate licensees in the area. A client relies on an agent's representations; therefore, an agent must exercise care not to offer advice outside of his or her field of expertise.</p>
---------------------------	--

**Full disclosure of Conflicts of Interest** is required when agents buy or sell real estate as a principal to the transaction (for themselves). This makes sense, as the public has the right to know when the other person, they are dealing with holds an active real estate license and is therefore more knowledgeable than a typical buyer or seller. This disclosure is usually made orally as well as documented in writing.

Disclosure is also usually required when agents recommend companies that they partially or fully own (like inspection, title, or mortgage services) as the agent may profit from the recommendation. While its always important to recommend legal counsel to clients, in this scenario, disclosure may be required. The other party must consent to the use of this other service provider; hiring of the affiliated company can't be assumed or forced.

Likewise, an agent is required to disclose their agency status to other third parties to the transaction at their first significant contact and prior to any substantive assistance. All states require such disclosure, however states vary as to the form of disclosure and when, where and to whom agents must reveal their agency relationships.

## ***Primary Forms of Agency Relationships***



**Single agency** - One of the most pervasive forms of agency relationships is the single agent. This agent represents only one party in a transaction as an agent. For example, as a seller's single agent, the listing agent's only principal is the seller. As a buyer's single agent, the selling agent's only principal is the buyer.

**Dual agency** – What if the broker/brokerage firm has an agency agreement with a seller and an agency agreement with a buyer who wants to buy that seller's property? Dual agency would allow the agent to represent both the buyer and the seller as an agent in the

same transaction. But this situation contains an inherent conflict of interest; how can the broker be obedient and loyal to the seller and the buyer at the same time in the same transaction? Since many of an agent's fiduciary duties can only be rendered to one party, dual agency is, by definition, difficult, if not impossible.

In states that permit dual agency, the agent must meet strict disclosure requirements and both principals must agree in writing to proceed with the dual agency relationship. This is referred to as **disclosed dual agency**. The "OLDCAR" fiduciary duties are then amended to remove full disclosure and undivided loyalty. But remember implied agency? If the agent unintentionally or through carelessness creates an implied dual agency relationship through his or her actions and without written disclosure, this is called **implied or undisclosed dual agency** and is a violation of license laws.

## *Subagency and Designated Agent*

A **subagent** is an agent of an agent. If authorized by the **principal** (the buyer or the seller), the **agent** (broker/brokerage firm) may delegate some of its authority to another licensed individual (salesperson) to assist the agent in carrying out the agent's services to the client.

For example, in those states that allow subagency, if the brokerage firm/broker is an agent for a seller and has hired salespeople as agents, then the salespeople would owe fiduciary duties to the broker and by extension, his or her clients. Therefore, all salespeople would be subagents of all the broker's clients; every salesperson knows all clients' confidential information, and all serve the broker's clients. When licensees know all clients' confidential information, we call this **imputed knowledge**.

Before buyer agency was established in the early 1990s, salespersons at ABC Realty Company working with **unrepresented** buyers would owe fiduciary duties to 123 Real Estate Company if their unrepresented buyer wanted to make an offer on 123 Real Estate Company's listing (property available to purchase). This cooperating salesperson would be a subagent of the listing broker, and ultimately to the listing broker's

principal (the seller). Everyone represented the seller principal in this scenario.

As an alternative to subagency, some states have implemented a **designated agency** system where the broker/brokerage firm is the agent to the seller or the buyer, however a salesperson at the firm has been designated to provide fiduciary duties to the principal on the broker's behalf.

In this scenario, the designated agent for the seller keeps the seller's information confidential and owes obedience and loyalty to this principal. Another salesperson at the same brokerage firm could be designated to owe fiduciary duties to a buyer who wants to make an offer on the seller's property; that salesperson would keep the buyer's confidential information confidential. Therefore, with designated agency, there's no imputed knowledge or assumption that all licensees at a company know all company clients' confidential information.

### ***Responsibilities of Agent to Customers and Third Parties***

When acting as an agent for one party, licensees do have certain obligations to customers and third parties even though they do not represent them.



#### ***A Helpful Trick: DAH (As in Ta -Dah)***

An agent's duties to people they do not represent are easily remembered using the acronym "DAH" (Like Ta-Dah) which stands for Disclosure of material facts, Accounting and Honesty.

Disclosure	Agents must disclose their agency/nonagency relationship to the party with which they do have a relationship, property conditions, adverse material facts, and environmental hazards to the customer.
Accounting	Agents must safeguard and account for all monies, documents, and other property received from a customer. State license laws will regulate the agent's accounting obligations and escrow practices.
Honesty	Agents must deal fairly and honestly with third parties. They must not misrepresent material facts.

When it comes to handling material facts, there's a difference between **intentional misrepresentation** or **fraud**, which is knowingly misleading someone with the intent to deceive and potentially injure another party, and **negligent misrepresentation**, which is not intended to mislead, but rather is the providing of incorrect information or lack of information concerning a material fact.

Agents must be honest and ethical and not make false or misleading statements about a property being sold or being considered by a customer. In reference to advertising, it's understood that there is a difference between using appealing language and blatant fraud or misrepresentation. **Puffing** refers to one's ability to "talk up" a property in a way that reflects an opinion. Therefore, it's not illegal to say that a home has "wonderful views of the city" or is "the best buy in the neighborhood."

## *Termination of Agency*

Certain events will terminate an agency relationship.

- **Full performance** - The completion of the reason the agency relationship was created will terminate the relationship (i.e., the sale of the house).
- **Mutual agreement** - The parties can mutually agree to terminate the agency relationship.
- **Expiration date** - The agency relationship automatically terminates on the expiration date of the agency agreement, whether the obligations were performed or not.
- **Death or incapacity of either the principal or broker**
- **Abandonment by the agent**
- **Condemnation or destruction of the property**
- **Bankruptcy or termination by force of law (ex: foreclosure sale)**
- **Breach of Agreement** - If one of the parties to the agreement defaults on their obligations, the damaged party may have a potential financial claim against the defaulting party.

## *Non-Agency*

In response to dual agency, some states have implemented another type of relationship called **non-agency**, where the licensee is a **transaction broker** or **facilitator**. A facilitator represents no one as an agent in the transaction, and therefore does not advocate the interests of either party. The facilitator (as are all real estate professionals and agents) is expected to treat all parties honestly, competently, and equally, and would not disclose confidential information to either party. Where the agent is like a coach, a non-agent is more like a referee and would not negotiate or advocate for either the seller or the buyer. A facilitator must be neutral.

### *A Helpful Trick: CARD*



A non-agent's duties to the client are easily remembered using the acronym "**CARD**," which stands for **Confidentiality**, **Accounting**, **Reasonable Skill and Care** and of material facts.

#### Confidentiality

A non-agent must hold in confidence any personal or business information received from the client. A non-agent may not disclose any information that would harm the client's interests or bargaining position, or anything else the client wants to keep secret. Specifically, the client's **motivating factors** (why they want to sell, or that they'd accept less than their asking price or different financing terms than what they've stated) must be kept confidential.

*Confidentiality is one of the duties that extends beyond the termination of an agency agreement. At no time in the future may the agent disclose confidential information.*

#### Accounting

A non-agent must safeguard and account for all monies, documents, and other property (think keys or garage door remote controls) received from a client or customer. State license laws will regulate the agent's accounting obligations and escrow practices.

#### Reasonable Skill and Care

The agent is hired to do a job and is therefore expected to do it with diligence and reasonable skill and care. A client relies on an agent's representations; therefore, an agent must exercise care not to offer advice outside of his or her field of expertise.

#### Disclosure

A non-agent has the duty to inform the client of all adverse material facts concerning the property transaction.

# Chapter 2 Key Point Review

---

1. Agency and Non-Agency Relationships
  - a. Common Law of Agency
    - i. Exists in every state.
    - ii. Sets up fiduciary obligations for all agents.
    - iii. With regard to real estate, refers to the nature of the relationship between the licensee and the parties to whom brokerage services are provided.
  - b. Principal (Client) – the client for whom the agent is providing a service.
  - c. Agent – the party hired to provide a service.
  - d. Customer – a person not under an agency agreement. The other party in a transaction.
  - e. Types of Agency
    - i. Special (Limited) Agent – authorized to represent one principal but cannot sign a contract on the client’s behalf.
      1. Real Estate Brokers are usually Special Agents.
    - ii. General Agent – Authorized to represent a party’s interest in a specific matter. General Agents have limited ability to bind their principal.
      1. Property Managers are usually General Agents.
      2. Salespeople are General Agents with their Employing Broker.
    - iii. Universal Agent – Authorized to represent the principal with virtually unlimited authority. Can act as the principal.
      1. Power of Attorney – written specific authority to sign documents and act as someone else.
      2. Attorney-In-Fact – the person who is given the rights in a Power of Attorney.
        - a. Power of Attorney usually must be recorded (Equal Dignities Rule)
        - b. Real Estate Agents should not act in the capacity of a Universal Agent in transactions for their clients.
2. Creation of Agency
  - a. Agency Relationships could be:
    - i. Express Agency – Created verbally or in writing.
      1. Required by the Statute of Frauds

- ii. Implied Agency – agency relationship created when, intentionally or inadvertently, actions indicate that the parties have consented to an agency relationship.
  - 1. It is not an express agreement.

### 3. Agent's Duties to Principals

- a. Fiduciary Duties – a relationship of trust and confidence between a principal and an agent.
  - i. Fiduciary obligations involve putting the client's interests above the agent.
- b. Full Disclosure of Conflicts of Interest
  - i. Needed when agents buy or sell real estate as a principal to the transaction (i.e. for themselves).
  - ii. Also required when agents recommend companies in which they have an ownership interest in.

### 4. Primary Forms of Agency Relationships

- a. Single Agency – The agent represents only one party in a transaction.
  - i. Advocates specifically for their client.
  - ii. Acts like a “coach.”
- b. Dual Agency – Where an agent represents both the buyer and seller in the same transaction.
  - i. Requires disclosure in states where it is allowed.
- c. Subagency and Designated Agent
  - i. A subagent is an agent of an agent.
    - 1. Salesperson may represent their Broker as their subagent.
    - 2. Salesperson owes fiduciary duties to the broker and the clients of the broker.
  - ii. Designated Agent
    - 1. Broker is the agent to the seller or buyer.
    - 2. Salesperson has been designated by Broker to provide duties to a principal on the broker's behalf.
- d. Non-Agency / Transaction-Broker / Facilitator – A facilitator doesn't represent any party in the transaction.
  - i. Is expected to act with neutrality towards all.
  - ii. Acts like a “referee.”
- e. Duties of an Agent
  - i. O.L.D.C.A.R.

1. Obedience – Agent must comply with the client’s directions and instructions if they are legal.
  - a. An agent who cannot obey a legal directive, must withdraw from the relationship.
2. Loyalty - The needs of the client must be placed above everyone else’s, including the agent.
3. Disclosure – The agent must inform the client of all material facts, reports and rumors that might affect the client’s interests in the property transaction.
4. Confidentiality – An agent must hold in confidence any personal or business information received from the client.
  - a. Confidentiality extends beyond the termination of an agency agreement.
5. Accounting – An agent must safeguard and account for all personal property of their client (money, documents, etc.)
6. Reasonable Skill and Care – An agent is expected to do their job with diligence and care.

f. Duties to Customers

i. D.A.H.

1. Disclosure – Agents must disclose their brokerage relationship with other parties in the transaction, as well as material disclosure of the property.
2. Accounting - An agent must safeguard and account for all personal property of their customer (money, documents, etc.)
3. Honesty – Agents must deal honestly with customers and not misrepresent material facts.

g. Duties of a Transaction-Broker (Facilitator/Non-Agent)

i. C.A.R.D

1. Confidentiality – A transaction-broker must hold in confidence any personal or business information received from the client.
  - a. Confidentiality extends beyond the termination of an agency agreement.
2. Accounting - A transaction-broker must safeguard and account for all personal property of their client (money, documents, etc.)
3. Reasonable Skill and Care – A transaction-broker is expected to do their job with diligence and care.
4. Disclosure – The transaction-broker must inform the client of all material facts concerning the property transaction.



## Chapter 2 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. The term “agent” refers to anyone with a real estate license.
2. An agent is a fiduciary in a relationship of trust and confidence with a principal who hired him/her to represent the principal in a transaction.
3. The common law of agency is only acknowledged in the United Kingdom.
4. Only roughly half of the states in the US utilize the common law of agency.
5. The principal is the person who hired an agent.
6. A customer hires an agent.
7. A principal is also considered unrepresented.
8. A limited agent is also known as a special agent and has a limited right to bind their principal.
9. A property manager is a general agent for their principal, the property owner.
10. A general agent is hired to do a series of acts for their principal and has a limited ability to bind their principal to a contract.
11. A salesperson is a general agent for a principal broker.
12. A Power of Attorney is the title given to a universal agent who has unlimited ability to bind a principal.
13. Real estate agents act as universal agents.
14. An attorney-in-fact replaces the principal and can sign contracts on behalf of the principal.
15. A single agent can represent two principals in the same transaction equally.
16. A listing agent is a single agent to the seller principal, while a selling agent is a single agent to the buyer principal.
17. A dual agent represents both a buyer and seller as an agent in the same transaction.

18. There are no conflicts of interest pertaining to fiduciary duties to both of the principals in a transaction in a dual agency relationship.
19. A dual agent must meet strict disclosure requirements and notify both principals.
20. When a seller and buyer have both hired the same brokerage firm to represent them, and the Broker does not utilize a Designated Brokerage relationship with their salespeople representing the seller and buyer, the brokerage firm/broker could be considered a dual agent.
21. A transaction-broker is also known as a non-agent.
22. A transaction-broker has an agency relationship with their principal and cannot be neutral.
23. A non-agent is not an advocate for either party.
24. The fiduciary duties of OLDCAR are owed to the principal by their agent.
25. The fiduciary duties of CARD are owed to the principal by the non-agent.
26. An agent only owes disclosure of material facts as a fiduciary to their client.
27. An agent must keep price, terms and motivation confidential on behalf of their principal.
28. A principal hires the licensee as an agent and the broker as a subagent.
29. A licensee is working with a seller. Another licensee in the same firm is working with a buyer. Their clients are under contract in the same transaction. Both principals hired the broker as an agent. The relationships now are dual agency with the broker, and the licensees are subagents.
30. The fiduciary duty of obedience is owed by a non-agent.
31. The fiduciary duty of full disclosure is owed by an agent.
32. Once a transaction has closed, agents can disclose a principal's confidential information.
33. The abbreviation OLDCAR pertains to the common laws of agency.
34. Both an agent and facilitator are responsible for properly accounting of their clients' monies and personal property.
35. A buyer's agent owes the fiduciary duty of confidentiality to a For Sale by Owner.

36. A For Sale by Owner customer has a relationship with the buyer's agent.
37. A seller's agent is required to disclose his relationship with his client to an unrepresented buyer.
38. An implied agency may be created simply through the actions of the broker.
39. An agent would be violating the fiduciary duty of obedience if he discloses the leaking roof to a prospective buyer when the seller asked the agent not to disclose this information.
40. State laws make it optional for sellers to disclose material facts.
41. Only showing properties that give the agent the highest commission, not what fits the client's best needs, is a violation of the fiduciary duty of loyalty.
42. Disclosure of adverse material facts is required by an agent, a non-agent, and by a licensee working with a customer.
43. An express agency can be created verbally and still be enforceable by the Statute of Frauds.
44. Implied agency is illegal.
45. Death of the principal will not terminate the agency relationship and will require the heirs to complete the contract.
46. When advertising, puffing is considered to be a misrepresentation of the property.
47. Fraud is a misrepresentation of a fact with the intent to deceive and potentially injure another party.
48. Negligent misrepresentation is the unintentional act of deceiving and potentially injuring another party.
49. Adverse material facts are generally defined as a fact that, if known, would affect a buyer's opinions or actions.
50. Both agents and non-agents must provide exceptional skill and care to their principals.
51. The fiduciary duty of accounting requires the responsible broker to provide copies of the operational business banking accounts to all clients.

52. An agent is like a coach while a non-agent or transaction-broker is more like a referee.
53. Agents must be neutral.
54. It's impossible to terminate an agency relationship.
55. Agency relationships are only terminated when the contract's expiration date is reached.
56. An agent keeps her seller's garage door code on a sticky note on her desk where others can see it. She is violating the fiduciary duty of accounting.
57. While agents must treat all parties fairly, non-agents do not have to.
58. An agent must disclose environmental hazards to a customer.
59. An agent always recommends his wife as a lender when working with buyers but doesn't disclose that she is his spouse. This is a disclosure violation.
60. Full disclosure is not required when agents buy or sell real estate as a principal to a transaction.

# 3

## Real Estate Laws and Ethics

**Federal Fair Housing Laws**

**Protection for Disabled Tenants**

**Exemptions**

**Enforcement**

**Equal Credit Opportunity Act**

**Americans with Disabilities Act (ADA)**

**Advertising and Technology**

**Antitrust Laws**

**Property Disclosure Laws**

**Environmental Issues Requiring Disclosure**

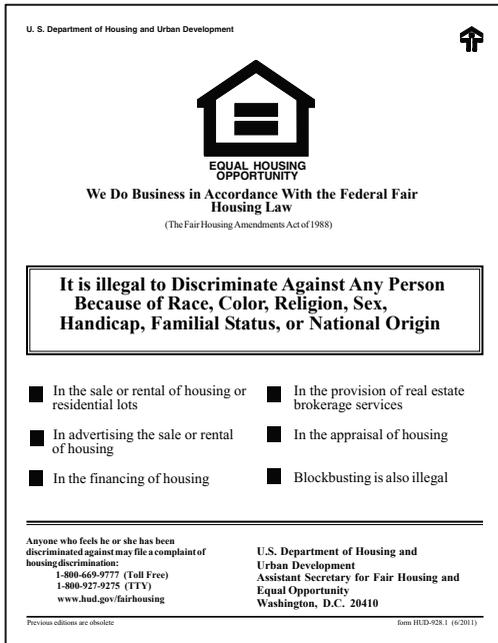
**Warranties**

Protecting the public is paramount. Both federal and state governments have passed numerous laws to ensure that people are treated fairly, specifically concerning anti-discrimination and fair business practices. Additionally, some trade organizations such as the National Association of REALTORS® have created **Codes of Ethics** to add another layer of commitment to not only what is legal to do, but what is the right thing to do when working with the public.

---

# Federal Fair Housing Laws

---



Although the **Civil Rights Act of 1866** prohibited racial discrimination in the buying, renting, selling, holding, or conveying of real and personal property, it was rarely enforced. In 1968, the Supreme Court ruled in *Jones v. Mayer* that all discrimination in selling or renting *residential* property based on race is prohibited under the provisions of the Civil Rights Act of 1866. **Title VIII of the Civil Rights Act of 1968**, also known as the **Federal Fair Housing Act**, strove to ensure that all Americans had an equal opportunity to live wherever they could afford to, making it unlawful to discriminate on the basis of the following protected classes: race, color, religion, or national origin.

In 1974, the **Housing and Community Development Act** added gender to the list of protected classes and required that the **Equal Housing Opportunity** logo poster be posted with the real estate brokerage firm's license(s). In 1988, the Federal Fair Housing Act was amended to add handicap and familial status.

## *A Helpful Trick: FRESH CORN*



The acronym “**FRESH CORN**” is an easy way to remember Federal Fair Housing protected classes. It is illegal to discriminate against the following: **Familial Status, Race, Sex, Handicap, Color, Religion and National Origin.**

Familial Status	<p>Those with minors in the household or pregnant people.</p> <p>Illegal activity includes charging higher security deposits to families, segregating families within buildings and maintaining “adults-only” complexes that do not constitute housing for older adults.</p>
-----------------	--

Race	<p>A group of people identified as distinct from other groups because of physical or genetic traits. The Civil Rights Act of 1866 makes it illegal to <i>ever</i> discriminate based on race.</p>
------	---

*E (placeholder) – one can remember it referring to “Equal”*

Sex	<p>One’s gender, including gender identity and sexual orientation.</p>
-----	--

Handicap / Disability	<p>A physical or mental impairment that substantially limits one or more of a person’s major life activities. Mentally ill people do not have to be receiving treatment. People who have AIDS, as well as alcoholics and drug addicts who have been diagnosed, treated, and are not currently addicted are included.</p> <p>Does not include the current illegal use of, or addiction to, a controlled substance. Convicted drug dealers are not covered under an condition, nor are any persons who have been convicted of the illegal manufacture of controlled substances.</p>
-----------------------	---

Color	<p>A person’s skin color or pigmentation.</p>
-------	---

*O (placeholder) – one can remember it referring to “Opportunity”*

Religion	<p>One’s cultural system of behaviors and practices, world views, sacred texts, holy places, ethics, and societal organization that relate humanity to an order or existence. The non-practice of religion is also included (atheism).</p>
----------	--

National Origin	<p>A person’s (or his or her ancestors’) country of birth or because a person has physical, cultural or linguistic characteristics of a national origin group.</p>
-----------------	--

Prohibited discriminatory acts include:

- Refusing to sell, rent, or negotiate with any person as a means of discrimination.
- **Unequal Services** – (disparate treatment) changing the nature or quality of brokerage services for different individuals as a means of discrimination, such as requiring female buyers to provide a lender’s pre-approval letter before showing property but not requiring the letter from male buyers.
- Making **discriminatory advertising** statements.
- **Discriminatory Misrepresentation** - representing that a property is unavailable as a means of discrimination.
- **Blockbusting**– (panic selling /panic peddling) making a profit by inducing owners to sell because of the prospective entry of minorities into the neighborhood. For instance, an agent who sends out fliers about the increased Latino presence in a neighborhood with a “list now” message.
- **Redlining** – discriminatory denial of loans or insurance to people in selected geographical areas, regardless of their qualification, based on the types of people who live in those areas.
- **Steering** – (channeling) leading prospective homebuyers to specific areas or avoiding specific areas either to maintain or to change the character of an area. For example, a builder community that showcases the area’s ethnic history and is trying to attract members of that ethnicity would be guilty of Steering.
- Denying membership in a multiple listing service or related groups as a means of discrimination.

A licensee may not disclose to a seller or landlord that a prospective buyer or tenant is a member of a protected class. Additionally, it is illegal for not only licensees but members of the public to discriminate against a protected class. For example, if a seller refuses a full-price offer because the person submitting the offer belongs to a protected class, that would be a Fair Housing violation. If a licensee goes along with their clients’ illegal actions, they too become liable.

Most states have passed their own Fair Housing laws, as have individual counties, cities and/or municipalities. These laws cannot conflict with federal law but can be stricter by, for example, adding more protected classes or covering more than just residential real estate transactions.

Lastly, remember the discussion on **puffing**, or a licensee's ability to "talk up" a property in a way that reflects an opinion? It may be a Fair Housing violation to call a property that is walking distance to a beach "waterfront property."

---

## Protections for Disabled Tenants

---

Under the 1988 amendment, landlords are required to allow disabled persons to make **modifications** to a dwelling at their own expense if these modifications are necessary for full enjoyment of the premises. A landlord may stipulate that the tenant restores the interior of the premises to premodification conditions when they leave. Additionally, landlords may not refuse to make reasonable accommodations in rules, policies, practices, or services.

There are a number of **accessibility** and **usability** requirements for certain types of newly constructed residential buildings. For example, access is required for common-use and public areas. Failure to design and construct for first occupancy, as of March 1991, an accessible route into and through a dwelling is also a violation. Adaptive and accessible designs must be implemented for the interior of the dwelling units.

If a mentally ill tenant is behaving inappropriately and reasonable action, such as counseling, has not solved the problem, the tenant may be evicted. In other words, a landlord does not have to tolerate such behavior by a mentally ill tenant whose tenancy would constitute a direct threat in substantial physical damage to the property of others or individuals.

---

## Exemptions

---

While the Federal Fair Housing Act exempts certain kinds of discrimination, anyone who feels victimized by discrimination based on race may seek legal recourse under the 1866 law.

The 1988 amendments provide a **senior exemption** from the familial status protection for housing intended for or occupied solely by persons 62 years of age or older, or housing intended for or occupied by at least one person 55 years of age or older per unit. Properties complying with the “55-or-older” exemption must have at least 80% of their units occupied by at least one individual who is at least 55 years old. Exemption properties also must publish policies and procedures that demonstrate the intent to provide housing for these individuals.

A person who owns a single-family home but who does not own more than three homes at one time, if certain conditions exist, can discriminate when selling or renting that home as long as a real estate licensee is not involved, and no discriminatory advertising is used. If the owner is not currently living in the home, or was not the most recent occupant, only one such exempt sale can be made within any two-year period.

When renting rooms or units in an owner-occupied, one-family to four-family dwelling, the owner can discriminate as long as a licensee is not involved, and no discriminatory advertising is used. For example, an ad stating, “female looking for female to share an apartment” would not be a violation.

Dwelling units owned by religious organizations may be restricted to persons of the same organization if membership is not restricted on the basis of race, color, sex (or gender), national origin, disability, or familial status. Lastly, private clubs may restrict the sale or rental of club lodgings to its members if the lodgings are not operated commercially.

---

## Enforcement

---

The 1988 amendments also made significant changes to how the Federal Fair Housing Act of 1968 is enforced, including authorizing administrative law judges to award both economic and non-economic damages, injunctive relief, and reasonable attorney fees and to impose civil penalties against violators. The amendments expanded the statute of limitations for initiating administrative proceedings to one year after the alleged discriminatory housing practice and authorizing administrative law judges within Housing and Urban Development (**HUD**) to hold contested case hearings. Lastly, HUD is required to proceed with cases on behalf of any person alleging that she or he has been the victim of housing discrimination, regardless of whether the alleged victim (complainant) provides his or her own legal counsel. The complainant is responsible for proving the discriminatory act took place.

Remedies under the amendments include:

- A civil penalty against the respondent, not exceeding \$16,000 for the first offense.
- A penalty not exceeding \$37,500 if another offense was committed within the past five years.
- A penalty not exceeding \$65,000 if two or more discriminatory practices have been found in the past seven years.
- An order for “appropriate” relief that may include actual damages, injunctive relief, and “other equitable relief.”
- A recommendation for disciplinary action against a named respondent whose licensure by a governmental agency is related to the complaint.

---

## Equal Credit Opportunity Act (ECOA)

---

The **Equal Credit Opportunity Act (ECOA)** of 1974 prohibits discrimination in lending on the basis of race, color, religion, national origin, sex, marital status, age, or dependency upon public assistance. This act keeps lenders from denying a 30-year loan to a 70-year-old applicant. A lender must also inform a rejected applicant in writing of reasons for denial within 30 days.

Other laws related specifically to lending are covered in Chapter 8.

---

## Americans with Disabilities Act (ADA)

---

This 1990 law affects real estate licensees by addressing disabled individuals' employment and public accommodations rights. The **ADA** provides for the employment of qualified job applicants regardless of their disabilities. As of July 26, 1994, any employer with 15 or more employees must adopt nondiscriminatory employment procedures and make reasonable accommodations that enable a disabled individual to perform her or his job duties.



The ADA (Title III) states that individuals with disabilities have the right to full and equal access to businesses and public services; thus, building

owners and managers must ensure that obstacles restricting those rights are eliminated. The ADA also provides comprehensive guidance for making public facilities accessible. The law seeks to protect property owners from incurring burdensome expenses to extensively retrofit an existing building by recommending reasonably achievable accommodations that will accomplish the purpose of providing access to the facility and services.

Because it costs less to incorporate accessibility features when designing a new building rather than to retrofit an existing building, new construction (including remodeling) must meet higher standards, i.e., be readily accessible and usable. Types of alterations that might be made to public facilities and services include:

- Attaching grab bars to restroom stalls
- Providing automatic-entry doors
- Converting information on real estate listings to large-print or audio format

A qualified individual with a disability has the right to be accompanied by a **service animal** specifically trained for that individual without being required to pay an extra charge for the service animal (i.e., a pet deposit) in or on the following places or during the following activities and subject to the conditions and limitations established by law and applicable alike to all individuals:

- Any place of employment, housing, or public;
- Any programs, services, or activities conducted by a public entity;
- Any public transportation service; or
- Any other place open to the public.

---

## Advertising and Technology

---

The **Telephone Consumer Protection Act (TCPA)** regulates unsolicited telemarketing phone calls. When licensees use telephone solicitation, they must identify themselves, on whose behalf they are calling, and how they can be contacted. Telemarketers must also comply with any do-not-call request made during the solicitation call. Consumers can place their home and wireless phone numbers on a national Do-Not-Call list, which prohibits future solicitations. Not all calls from companies or organizations are illegal under the Do-Not-Call guidelines. The following calls are allowed: Political calls, charitable calls, debt collection calls, purely informational calls and surveys. Likewise, if a person has done business (or sought to do business with you) in the past 18 months they can also legally be called.

The Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (**CAN-SPAM Act**) supplements TCPA by banning the sending of unwanted email “commercial messages” to wireless devices. It requires express prior authorization and requires giving an “opt out” choice to terminate the sender's messages.

---

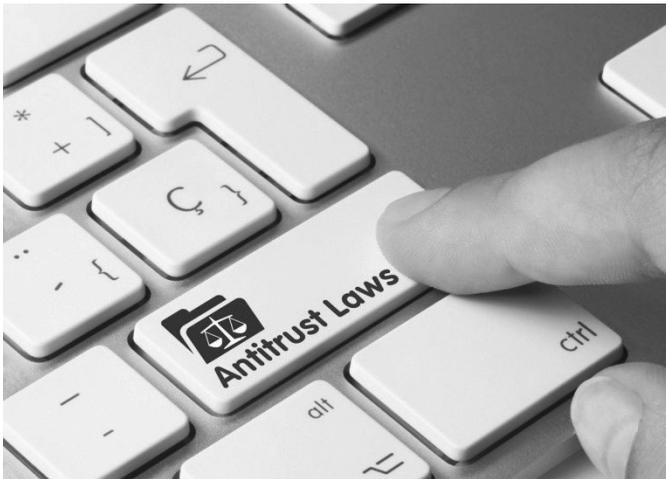
## Antitrust Laws

---

Antitrust laws seek to eliminate companies that restrict trade and attempt to monopolize an industry. Approved in 1890, the **Sherman Antitrust Act** declared it illegal for businesses to form a “combination” that results in restraint of trade or commerce. The following illustrate real estate business antitrust law violations.

**Allocation of customers or markets** refers to when more than one brokerage firm or real estate professionals at different firms agree to divide their areas and refrain from competing for each other's business. This division may take place on a geographic basis or on a certain price range of homes.

**Price fixing** is a conspiracy among brokerages to set prices for their services rather than negotiate those fees. A brokerage firm may institute a commission policy for its employed licensees, however different brokerage firms may not collude or set a "going rate" for commissions with their clients. Another example of price fixing would be a local board of REALTORS® that creates a policy whereby every member brokerage firm must charge the same commission rate to their clients.



When two or more businesses conspire against other businesses to reduce competition, **boycotting** has occurred. For example, if a real estate brokerage firm advertises a new business model that other companies disagree with, those companies cannot collectively decide not to show properties listed by the firm whose model they dislike.

Lastly, **tie-in agreements** refer to agreements to sell only if a buyer purchases another product as well. Imagine that a real estate professional has a listing for a house that a customer wants to buy. The listing licensee tells the customer that he will only sell the house to the customer if the customer agrees to list her or his house with the professional.

Real estate professionals who violate the Sherman Antitrust Act may be found guilty of a felony punishable by a maximum \$1 million dollar fine for an individual and ten years in prison. In a civil suit, a broker found guilty of a violation of the Sherman Antitrust Act is liable for triple damages plus attorney's fees and court costs.

---

## Property Disclosure Laws

---

Most states have seller property disclosure laws that require sellers to provide buyers with a **written property disclosure**. Sellers are responsible for disclosing any known **material facts** as well as any **latent (hidden) defects**. A **material fact** is a fact that, if known, would influence a buyer's decision to buy the property. Real estate professionals must also disclose all material facts about a property that are actually known by them, including information the seller provides. A **latent defect** is any defect that is not visible and would not be uncovered by a normal inspection, such as a basement that only floods in heavy rain. States that have written sellers' property disclosures require the listing broker or salesperson to supply the seller with the required document and have the seller complete the form, which will be given to buyers. The licensee should NEVER fill out a seller's property disclosure form.

When it comes to inspecting a property, the licensee's obligation varies from state to state. Some states require that the licensee complete a visual inspection. Real estate professionals have a responsibility to inquire about "red flag" issues that indicate a problem requiring closer inspection by an expert. Examples include musty odors, stains, foundation cracks, etc. Licensees who fail to disclose these issues could be liable and potentially face charges of fraud, as could the seller and the non-disclosing licensee's brokerage firm.

Buyers should also be informed about **professional home inspections**, which can take several hours to complete. A home inspector (who may or may not be licensed) will look for problems, such as mechanical, structural, or electrical issues. The buyers may wish to accompany the inspector so they can ask questions. Most states' purchase contracts include an inspection contingency that allows the buyer to either ask the seller to make repairs or terminate the contract.

Known property **alterations** and **additions** must be disclosed. Alterations or additions made without a building permit may be illegal and pose serious safety problems, therefore the municipality's code enforcement

officials have the legal authority to require those permits and place penalties on a property owner for non-compliance. The buyer (after closing) could be required to remove the alterations at their expense.

**Stigmatized properties** are those perceived negatively by some people because of events that have occurred in them (murder, suicide, deaths, hauntings, etc.). Disclosure requirements for stigmatized properties are set by state law. Properties (or neighborhoods) can be stigmatized by the presence of convicted sex offenders. **Megan's Law** is a federal law that requires states to notify the public about the presence of convicted sex offenders in a community.

Sellers are responsible for accurately representing their property's size as well as any issues that affect its borders like fence issues, overhanging trees or known survey errors. **Proposed zoning uses or changes** impact a property's condition and, if actually known, must be disclosed. These uses or changes are generally administered through a planning department. Misrepresenting zoning information or information on a building permit can result in the city issuing a stop work order or even the revocation of permits, which might require a structure to be torn down. Providing false information to a city also could result in fines or jail time.

---

## Environmental Issues Requiring Disclosure

---

Real estate licensees must be aware of possible environmental hazards and where to get professional advice. External hazards include any impact on air quality, noise, or public health and safety. Environmental site assessments identify these types of hazards. Real estate licensees are generally not responsible for disclosure of environmental hazards unless it can be shown that they should have been aware. The following environmental issues, if present, must be disclosed:

- **Pest infestations** such as termites or bed bugs.
- **Radon** is an odorless radioactive gas produced by the decay of naturally occurring radioactive materials in rocks under the earth's surface. Long-term exposure to radon has been linked to lung cancer. The U.S. Environmental Protection Agency (EPA) has established radon levels that are thought to be unsafe. Testing techniques allow homeowners to determine the exact quantity of radon in their homes. If a home is determined to have radon gas, the seller may, if the contract requires, be obligated to mitigate the hazard, whether the danger is actual or only perceived. Buyers also should be aware of the existence of radon in soil.
- **Asbestos.** Used for many years as insulation on plumbing pipes and heat ducts and as general insulation because it is a poor heat conductor, **asbestos** was also used in floor, ceiling and roofing materials. While relatively harmless if not disturbed, asbestos can become life threatening during its removal because of the accompanying dust. The process of sealing asbestos is called **encapsulation**. Exposure to asbestos dust may happen if the asbestos ages and starts to disintegrate (become **friable**).
- **Carbon monoxide.** Water heaters, fireplaces, furnaces – basically any system using combustion -- can produce a colorless, tasteless, odorless and deadly gas called **carbon monoxide**. Most communities have made carbon monoxide detectors mandatory in residential buildings.
- **Mold** is an organism that may cause people to have allergic reactions. Annual maintenance checks (around toilets, showers, and sinks) help to detect mold in its early stages. Dehumidifiers, proper ventilation, perimeter drainage, and sump pumps help reduce mold by removing water from the property. Most homeowners' insurance companies set



dollar limits for mold claims or make mold problems an exclusion of the homeowner's policy. Common varieties of mold can cause allergic reactions as well as asthma episodes, infections, and other respiratory problems. Mold does not emit toxins.

- The buyer should be made aware of the existence of a **septic tank**; an alternative system for waste disposal where there is no sewer system available.
- **Lead** is a chemical element that has been used extensively because of its ability to impede water flow and its rust resistance. Lead can be found in peeling paint and water systems. Unfortunately, it becomes a health hazard when it is ingested or inhaled. Children under six years of age are most vulnerable to exposure to lead-based



paint. Lead was banned for use in 1978. Owners of properties built prior to 1978 must disclose to buyers or renters the presence of lead-based paint hazards, if known to the seller/landlord. A **lead-based paint disclosure** must be attached as a separate item to all real estate sales and lease contracts on pre-1978 residential properties. Some states may extend the disclosure requirements to commercial properties as well.

Real estate professionals must distribute a federal lead hazard pamphlet to buyers and renters. Buyers will have up to 10 days to have a lead-risk assessment performed on the property. Lack of disclosure prior to contracting may make contracts void and leave the seller and real estate licensees exposed to heavy fines and penalties.

---

## Warranties

---

**Home warranty** programs are used for previously owned homes. They are often purchased by the seller to provide reassurance to potential buyers regarding the condition of items, such as the plumbing, major appliances, and mechanical systems. Each warranty company has a different contract and coverage. Home warranty programs provide for the replacement or repair of a home's mechanical systems and major appliances in the case of a break-down due to normal use. These differ from homeowner's or hazard insurance, which covers a catastrophic event that damages a home such as a roof destroyed by a hailstorm or a fire.

All states have some form of a new construction warranty that protects buyers from defects caused by faulty workmanship or faulty materials that do not comply with building standards. Builders may also provide additional warranties on new homes. Warranties generally provide limited coverage on workmanship. Coverage can extend up to 10 years on certain parts of the home.

# Chapter 3 Key Point Review

---

1. Federal Fair Housing Law
  - a. Civil Rights Act of 1866 – prohibited racial discrimination in the buying, renting, selling, holding, or conveying real and personal property.
  - b. Jones v. Mayer (1968) – Discrimination in selling or renting residential property based on race is prohibited.
  - c. Title VII of the Civil Rights Act of 1968 – Also known as the Fair Housing Act, added the protected classes of race, color, religion and national origin.
  - d. Housing and Community Development Act of 1974 – added gender and the requirement to display the Fair Housing Poster.
  - e. Fair Housing Act Amendment of 1988 – added handicap and familial status.
  
2. Fair Housing Act Protected Classes (F.R.E.S.H. C.O.R.N.)
  - a. F – Familial Status
    - i. Protects minors in the household or pregnant people.
  
  - b. R – Race
    - i. Protects people identified as distinct from other groups because of physical or genetic traits.
  
  - c. E – (no term) – utilized to create the word abbreviation
    - i. Reminder of “Equal”
  
  - d. S – Sex (Gender)
    - i. Protects people based on their gender, gender identity and sexual orientation.
  
  - e. H – Handicap / Disability
    - i. Protects those with physical or mental impairment.
    - ii. Does not include illegal use, or addiction to, controlled substances.
  
  - f. C – Color
    - i. Protects people based off of their skin color or pigmentation.
  
  - g. O – (no term) – utilized to create the word abbreviation
    - i. Reminder of “Opportunity”
  
  - h. R – Religion
    - i. Protects based off a person’s cultural, world view, sacred text, holy places, ethics or societal constructs.
    - ii. Also includes the non-practice of religion.

- i. N – National Origin
  - i. Protects a person based on them or their ancestor’s country of birth.
  - ii. Also provides protection based off physical, cultural or linguistic characteristics of a national people group.

### 3. Prohibited Discriminatory Acts

- a. Refusing to sell, rent or negotiate with any person as a means of discrimination.
- b. Unequal Services (Disparate Treatment) – Changing the nature of brokerage services for different individuals as a means of discrimination.
- c. Discriminatory advertising
- d. Discriminatory Misrepresentation – representing a property is unavailable when it is, in fact, available.
- e. Blockbusting – making a profit by inducing owners to sell because of the entry of minorities into a neighborhood.
- f. Redlining – denial of loans or insurance to people in selected geographic areas.
- g. Steering – leading prospective homebuyers to specific areas or avoiding specific areas based on a protected class status.
- h. Denying membership in a multiple listing service or related groups as a means of discrimination.
- i. A licensee may not disclose to a seller or landlord that a prospective buyer or tenant is a member of a protected class.

### 4. Protection for Disabled Tenants

- a. Landlords are required to allow disabled persons to make modifications to a dwelling at their own expense if the modifications are necessary for full enjoyment of the premises.
  - i. The landlord may require the tenant restores the interior to its original condition when they leave.
- b. Landlords may not refuse to make reasonable accommodations in rules, policies, practices, or services.

## 5. Exemptions

- a. Senior Exemption from Familial Status Protection
  - i. Housing occupied solely by persons 62 years of age and older.
  - ii. 80% of units occupied by at least one individual who is at least 55 years old.
- b. A person who owns a single-family home, but not more than three homes
  - i. A real estate licensee cannot be involved.
  - ii. No discriminatory advertising is used.
  - iii. Discrimination cannot be based on race.
- c. Renting rooms or units in an owner-occupied, one-family to four-family dwelling.
  - i. Same rules apply as above in (b).
- d. Dwellings owned by religious organizations may be restricted to persons of the same organization.
  - i. Membership cannot be restricted based on race, color, sex (or gender), national origin, disability, or familial status.
- e. Private clubs may restrict the sale or rental of club lodgings to its members if the lodgings are not operated commercially.

## 6. Enforcement

- a. Enforcement allows for economic and non-economic damages, injunctive relief, reasonable attorney's fees and imposing civil penalties against violators.
- b. Enforcement actions must be initiated with HUD within one year after the alleged discriminatory practice.
- c. Actions brought before the courts must be initiated within two years.

## 7. Equal Credit Opportunity Act

- a. Prohibits discrimination in lending based on race, color, religion, national origin, sex marital status, age, or dependency upon public assistance.
- b. A lender must inform a rejected applicant in writing of reasons for denial within 30 days.

## 8. Americans with Disabilities Act (ADA)

- a. Provides for the employment of qualified job applicants regardless of their disabilities.
- b. Any employer with more than 15 employees must adopt nondiscriminatory employment procedures and make reasonable accommodations that enable a disabled individual to perform her or his job duties.
- c. Title III states that individuals with disabilities have the right to full access to business and public services.
  - i. There are some protections for owners of older buildings having to incur burdensome expenses bringing their buildings up to ADA standards.
  - ii. New buildings have a higher requirement for accessibility standards.
  - iii. Modifications that might be made:
    - 1. Grab bars in restroom stalls
    - 2. Automatic-entry doors
    - 3. Converting information on real estate listings to large-print or audio format.
- d. A qualified disabled individual has the right to be accompanied by a service animal without being required to pay an extra charge for the service animal.
- e. ADA allows for several remedies for a person who is discriminated against.

## 9. Advertising and Technology

- a. TCPA (Telephone Consumer Protection Act)
  - i. Regulates unsolicited phone calls.
  - ii. Caller must identify themselves, on whose behalf they are calling, and how they can be contacted.
  - iii. Must comply with any do-not-call requests during the call and are prohibited from calling individuals who have placed their name on a registered do-not-call list unless prior engagement has been initiated by the consumer.
- b. CAN-SPAM Act (Controlling the Assault of Non-Solicited Pornography and Marketing)
  - i. Bans the sending of unwanted email “commercial messages.”
  - ii. Requires prior authorization and requires giving an “opt-out” choice to terminate further messages.

## 10. Antitrust Laws

- a. Seeks to eliminate companies that restrict trade and attempt to monopolize an industry.
- b. Sherman Antitrust Act declared it illegal for business to form a “combination” that results in restraint of trade or commerce.
- c. Illegal practices
  - i. Allocation of Customers or markets – firms agree to divide their areas and refrain from competing for each other’s business.
  - ii. Price fixing – a conspiracy among brokerages to set prices for their services rather than negotiate those fees.
  - iii. Boycotting – when two or more businesses conspire against other businesses to reduce competition.
  - iv. Tie-in Agreements – Agreements to sell only if a consumer purchases another product as well.
- d. Violators of the Sherman Antitrust Act may be found guilty of a felony and could face a 10-year prison term and up to a million dollar fine.

## 11. Property Disclosure Laws

- a. Sellers are responsible for disclosing any known material facts as well as any latent (hidden) defects.
  - i. A material fact is a fact, that if known, would influence a buyer’s decision to buy the property.
  - ii. A latent defect is any defect that is not visible and would not be uncovered by a normal inspection.
- b. Real estate professionals must also disclose all material facts about a property that are actually known by them.
- c. Some states have written Seller’s Disclosures that can be completed.
  - i. They should never be completed by the licensee, only the Seller.
- d. Some states require licensees to perform a complete visual inspection of the property.
- e. Real estate professionals have an obligation to inquire about “red flag” issues that indicate a problem requiring closer inspection by an expert.
- f. Known alterations and additions and violations of zoning must be disclosed.

- g. Measurements, survey issues or known encroachments must be disclosed.
- h. Stigmatized Property issues – items perceived negatively by some people (murders, suicides, deaths, hauntings, etc.) vary from state to state on disclosure requirements.
- i. Megan’s Law – a federal law that requires states to notify the public about the presence of convicted sex offenders varies from state-to-state regarding disclosure requirements.

## 12. Environmental Issues Requiring Disclosures

- a. Pest Infestations – bed bugs, termites, etc.
- b. Radon – an odorless radioactive gas produced by decay of naturally occurring radioactive materials.
- c. Asbestos – used as insulation for plumbing pipes and heating ducts. Also used for floor, ceiling and roofing materials.
- d. Carbon monoxide – a colorless, tasteless, odorless, and deadly gas associated with water heaters, fireplaces and furnaces.
- e. Mold – biological organism associated with moist conditions and humidity.
- f. Lead – chemical element utilized in pipes and paint products pre-1978.
  - i. Owners of properties built prior to 1978 must disclose to buyers or renters the presence of lead-based paint hazards if known by the seller/landlord.
    - 1. A Lead Based Paint Disclosure must be attached as a separate item to all real estate sales and lease contracts on properties built prior to 1978.
    - 2. Some states require disclosure on commercial properties as well.

## 13. Warranties

- a. Home Warranty programs are used for previously owned homes.
  - i. Usually purchased by the seller to provide reassurance to potential buyers regarding the condition of mechanical items and systems in the home.
- b. New Construction Warranty – protects buyers from defects caused by faulty workmanship or faulty materials.
  - i. Usually state mandated.
  - ii. Builders may provide additional warranties.
  - iii. Coverage may extend up to 10 years on certain parts of the home.

## Chapter 3 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. The Civil Rights Act of 1866 prohibits discrimination against color.
2. Title VIII of the Civil Rights Act of 1968 is also known as the Federal Fair Housing Act.
3. National origin is defined as a group of people identified as distinct from other groups because of physical or genetic traits.
4. The Federal Fair Housing Law prohibits discrimination against handicap, color, familial status, religion, age, national origin, and race.
5. As a protected class, sex refers to one's gender, including gender identity and sexual orientation.
6. Familial status protects those with children under the age of 18 and pregnant people.
7. Property owners are allowed to separate an apartment complex into an adult section and a family-friendly section for the safety of the children.
8. Senior housing is allowed to discriminate against familial status so long as at least 80% of the units are occupied by at least one individual who is 55 years old or older.
9. A person with AIDS is protected under the classification of handicap.
10. A landlord must allow a disabled tenant to make necessary modifications to the premises.
11. A landlord must pay for the modifications to the premises on behalf of the disabled tenant.
12. A disabled tenant may be required to remove any modifications done to the premises and pay for the reversal of the modifications.
13. A real estate professional is allowed to disclose to a seller or landlord that a prospective buyer or tenant is a member of a protected class.
14. Alcoholics and drug addicts seeking treatment are protected under the Federal Fair Housing Act.
15. Convicted drug dealers are protected under the handicap classification.

16. A landlord may evict a mentally ill tenant with a violent history.
17. A landlord or property manager may charge a pet deposit for a service animal.
18. A building built after March 1991 that does not comply with handicap accessible units and routes into and through the building is considered to be a failure to design.
19. Older building owners are required to make reasonable, achievable access accommodations for the disabled community.
20. The Americans with Disabilities Act gives those with disabilities the right to full and equal access to public accommodations.
21. An aggrieved party may go to Housing and Urban Development to file a complaint within two years of alleged disparate treatment.
22. An aggrieved party may file a complaint with the federal court within two years of alleged disparate treatment.
23. Exemptions from Federal Fair Housing law are allowed so long as the property owner does not use a broker, use discriminatory advertising, currently lives in the home, and does not own more than three properties at one time.
24. There are no exemptions from Federal Fair Housing law.
25. Individuals who have been convicted of a crime are protected under Federal Fair Housing laws.
26. A landlord is allowed to discriminate against the protected classification of race so long as the landlord does not use a licensed property manager.
27. A religious organization may restrict to person of the same religion if membership is not restricted on the basis of familial status, race, sex, handicap, color and national origin.
28. A private club may restrict lodging to its members only if lodgings are operated commercially.
29. Providing unequal services is also known as disparate treatment.
30. Requiring Hispanic buyers to provide a lender's pre-approval letter before showing property but not requiring the letter from Caucasian buyers is an example of steering.

31. A broker is required to accept all listings, even if the owner intends to violate the Federal Fair Housing laws to protect the value of the neighborhood.
32. A brokerage firm is required to post the Equal Housing poster in their place of business to avoid being accused of disparate treatment.
33. The law allows two or more brokerages to boycott another brokerage to reduce competition.
34. Multiple brokerage firms all agreed to charge the same commission rate to the public. This is price fixing and illegal and is addressed by the Sherman Antitrust Law.
35. Redlining is a discriminatory denial of loans or insurance due to selected areas, regardless of their qualification.
36. HUD allows a professional to describe who should live in the property in the advertisement.
37. Blockbusting is leading prospective buyers to or away from specific areas based on a protected classification.
38. Steering is also known as channeling.
39. Blockbusting is also known as panic selling or panic peddling.
40. Steering is inducing owners to sell their property because a minority has moved into the neighborhood.
41. State laws make it optional for sellers to disclose material facts.
42. Both sellers and licensees fill out the property disclosure before it is given to the buyer.
43. Sellers are required to disclose both obvious and latent defects that they are aware of to prospective buyers.
44. ECOA requires that all rejected credit applicants be informed in writing the reason(s) for credit denial within 30 days.
45. The CAN-SPAM Act addresses the regulation of unsolicited telemarketing phone calls.
46. Licensees do not have to abide by the Do-Not-Call list.

47. When the responsible broker at a company tells all agents they must negotiate commissions with clients between 6% and 8% they are price fixing.
48. A latent defect is any defect that is visible and would be uncovered by a normal inspection.
49. The Seller must disclose if they know of an ongoing or existing Environmental Impact Statement.
50. Lead hazards must be disclosed on properties built prior to January 1, 1979.
51. Lead hazards can be found in paint, soil and pipes.
52. It is safer to encapsulate asbestos than abatement.
53. Lead-based paint and asbestos removal is a standard coverage in an owner's title policy.
54. Radon is an odorless, colorless gas that is a known human carcinogen that should be mitigated once it is discovered through a radon test.
55. Carbon monoxide is a colorless, odorless gas which can cause sudden illness and even death.
56. If a combustion appliance is not operating properly, it may increase concentrations of radon.
57. Hidden structural damage is an example of a latent material defect.
58. A latent defect is considered a material fact.
59. A buyer should receive both the lead-based paint disclosure and the EPA pamphlet, Protect Your Family from Lead in Your Home, from a Seller.
60. Lead-based paint hazards must be disclosed with both residential and commercial properties if built prior to January 1, 1978.
61. Home warranty programs are used for previously owned homes.
62. A Hispanic student is protected by the Federal Fair Housing Act.

# 4

## Real versus Personal Property

**What is Land?**

**Legal (Property) Descriptions**

**Math – Measuring Property**

**Personal Property**

---

### What is Land?

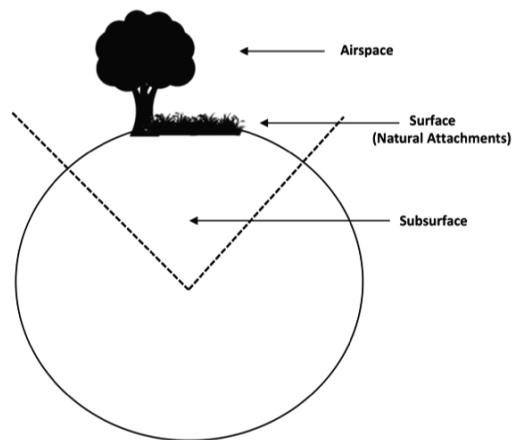
---

Property can be described in several ways. First, there's **land**, which specifically refers to the surface, all natural things attached to it, what's below the surface all the way to the middle of the earth, and the **airspace** above the surface. Therefore, when one owns land, one owns not just the top layer, but the trees, shrubs, hills, etc. on top of that dirt, as well as what's called the **subsurface**, to include the dirt, rocks, minerals, gas, oil, and water below. These **subsurface rights**, or rights to the resources below the earth's surface, may be sold separately from the surface rights or they may be leased to others. Additionally, the air above the land all the way to space is considered part of the land.

For example, a person owns 100 acres, and that includes the surface, subsurface and air. They have no plans to dig for oil, however they hire a geologist who informs them that there is, in fact, oil beneath their land. Since they own that oil, they could sell the rights to pull it from their land

to someone else. If they do, they as the surface owner cannot restrict access to that oil or any sold subsurface rights. They can be compensated for surface damage to obtain those subsurface minerals or oil. Subsurface rights are considered real property and transferred separately by deed.

The same goes for air rights or the right to use the space above a parcel of land. Air rights may be sold or leased separately from the surface rights. Of course, those air rights might be limited by law (fly-zones for airports, etc.). Air rights are also considered real property and transferred separately by deed.

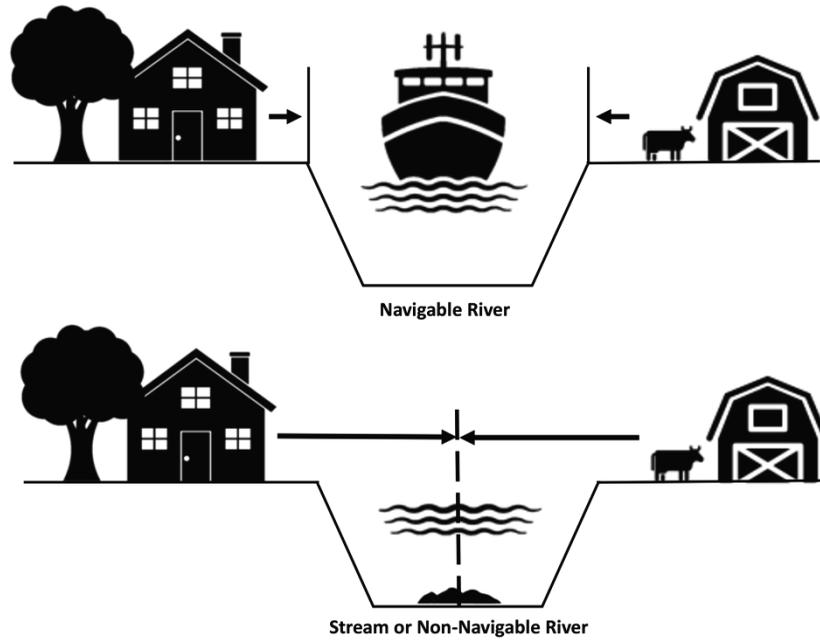


**LAND – encompasses all natural attachments on the surface to the center of the earth, and up into space.**

Rights surrounding water beneath, across or adjacent to land are handled differently based on either common law (historical) or state statute. These **water rights** also vary depending on whether that water is a river, lake, or ocean. Water rights may also be tightly regulated by the state in water-critical areas.

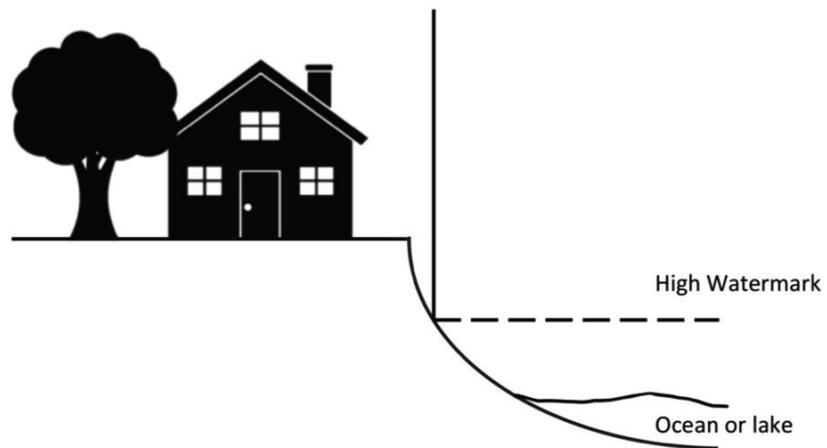
Common law covers both riparian and littoral rights. When discussing rivers and streams, **riparian** rights (remember **Riparian = River**) vary depending on the size of that moving water. If the river is navigable, property owners own land to the water's edge. A navigable river is one large enough to be traveled on by ship or boat, like the Mississippi River. If the river or stream is non-navigable, then property owners own the underlying land to the midpoint of the stream or river. Ownership of that land may not actually include the right to use the water on or beside it.

## RIPARIAN RIGHTS



Properties on lakes, oceans and seas, on the other hand, have what are considered **littoral** rights (remember Littoral = Lake). Littoral rights refer to large bodies of water. While these properties enjoy use of those waters, ownership extends only to the high-water mark, or the highest level that water reaches over land. Water is considered a **public easement**.

## LITTORAL RIGHTS



Oceans, Seas and Lakes

When the right to use water is controlled by the state rather than by the landowner whose property is adjacent to the water, then the **Doctrine of Prior Appropriation** is used to determine ownership. Usually found in states that are water critical, this doctrine requires that a landowner demonstrate to a state agency that the owner's plans are for a beneficial use. The priority of a water right is usually determined by the oldest recorded permit issued by the state. The issuance of the permit does not grant access to the water source. In these states, just because a property abuts a river or stream doesn't give the landowner any assumed rights to that water.

Easements (such as for ditch rights) might be necessary to access the water.

Lastly, water affects the land. Most commonly, water creates **erosion** or a gradual loss of land as water wears it away, such as when coastlines shrink over time as the ocean pulls sand from the beach. The opposite may also occur. **Accretion** is the addition of land as water deposits soil. Finally, where erosion is a slow process, the dramatic tearing away of soil via a natural disaster like a flood or landslide is called **avulsion**.

## ***Physical and Economic Characteristics of Land***

Land is physically characterized by being **immobile**, **indestructible**, and **unique**. The geographic location of any given parcel of land can never be changed; it is fixed. One can't pick up a parcel of land and move it somewhere else.

The geographic location of land will remain the same, regardless of its condition. Even if a wildfire blazed across a parcel of land, that land still survives and is therefore deemed indestructible. Improvements like a house, cabin or fence can be destroyed, but the land is considered permanent. An important point to note – since land is permanent, it does not depreciate. Again, the improvements on the land may lose value, but the land itself does not. We will see this principle in action when we cover land valuation.

Since no two parcels of property are exactly the same or in the exact same location, we say that land is inherently unique or non-homogenous. Consider two neighboring one-acre parcels. One is more north or east than the other. One may have slightly different soils, more rocks or fewer trees. The parcel on the left may be just slightly smaller than the one to the right. Each piece of land is unique.



We can also describe land from an economic perspective. Firstly, there's only so much of it. The concept of **scarcity** refers to the fact that the total supply of land is finite. As Will Rogers once said, "Buy land. They ain't making any more of the stuff."

Building an **improvement** on a parcel of land can dramatically change its value as well as its use, not only for the parcel but also the surrounding area. There is a **permanence of investment** when it comes to owning land. The return on the investment of adding improvements tends to be long term and fairly stable.

Lastly, **area preference** or location is considered the single-most important economic characteristic. Also referred to as **situs** or place, a plot of land's location is often a purchaser's primary concern. Is the land close to popular amenities like grocery stores or parks? Is it in a desirable school district? Is there a hospital or fire department nearby? Is the area stable or growing? All of these conditions economically impact land, albeit subjectively and based on the owner or a potential buyer's needs. That's why the most infamous saying about land is, "Location, location, location."

---

## Legal (Property Descriptions)

---

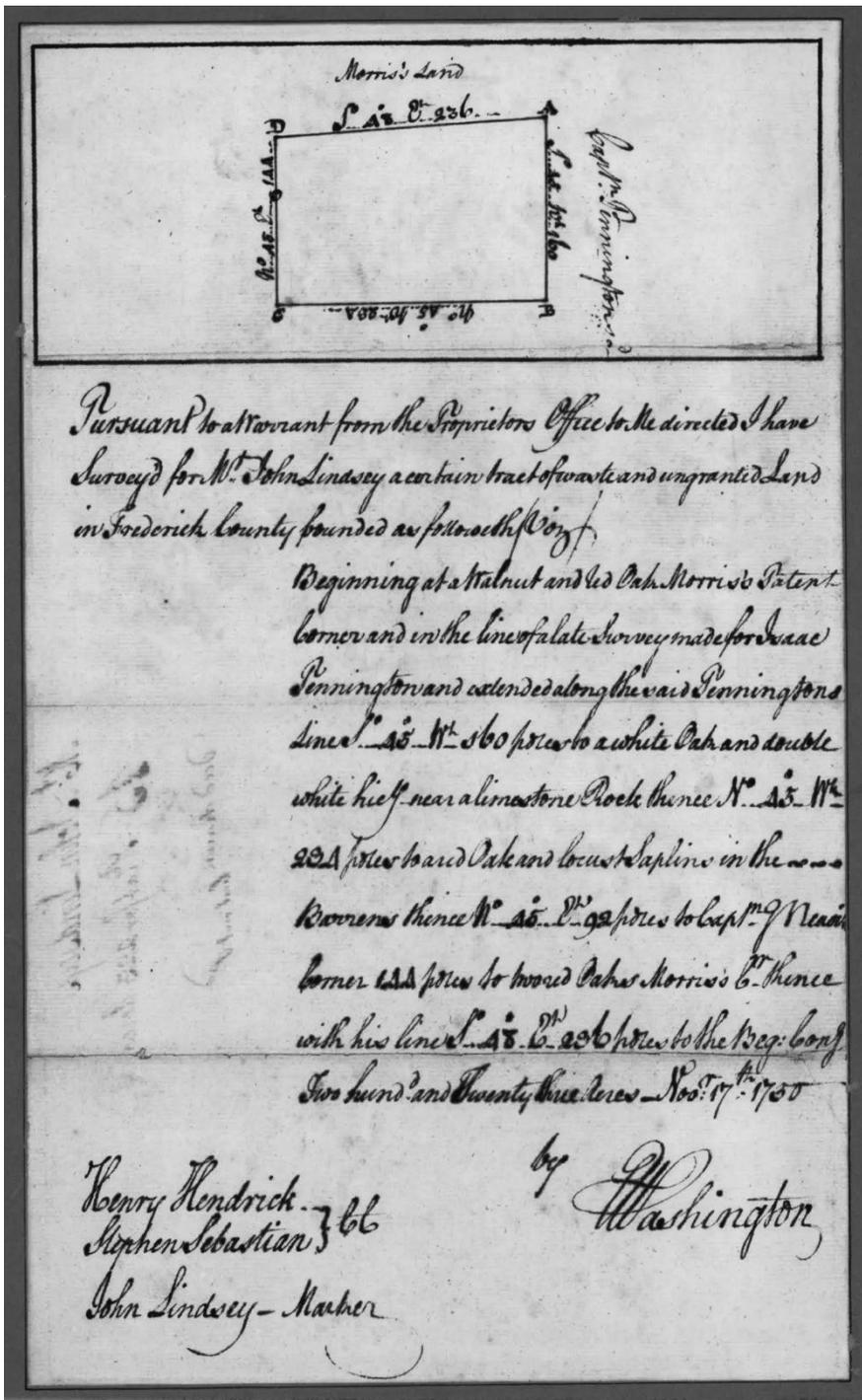
**Legal descriptions** are a detailed way of describing a parcel of land, and are required for deeds, easements and mortgages. States consider a legal description legally sufficient if it allows a surveyor to locate the parcel (define the exact boundaries of the parcel). A legal description may be based on information collected through a **survey**. Not all surveys are the same. An incorrectly worded legal description in a sales contract may result in a conveyance of more or less than the parties to the contract intended. Because street names change, they are not used as the legal basis of transferring property.

There are three methods of legally describing real estate: Metes and Bounds; Rectangular or Government Survey; and Lot and Block, otherwise known as Recorded Plat.

### *Metes and Bounds*

The oldest of the three, **metes and bounds** describes the perimeter of a property using landmarks, monuments, distances and angles. “Metes” means measurements of length and “bounds” refers to boundaries. Originating in Britain and therefore common in the original colonies on the east coast, metes and bounds legal descriptions can also be found throughout the country in locales settled through the 1800s.

Imagine you’re a young George Washington. It’s 1750, you are 18 years old and have been hired to survey 223 acres for Mr. John Lindsey (true story). You pick a starting point, called a point of beginning (POB) and walk the entire parcel, describing monuments or identifiable objects such as trees or creeks that establish an ending point for a mete. Each boundary line is identified by direction and length. Once you’re done you end up right where you started – the point of beginning. Here’s how you legally describe the land:



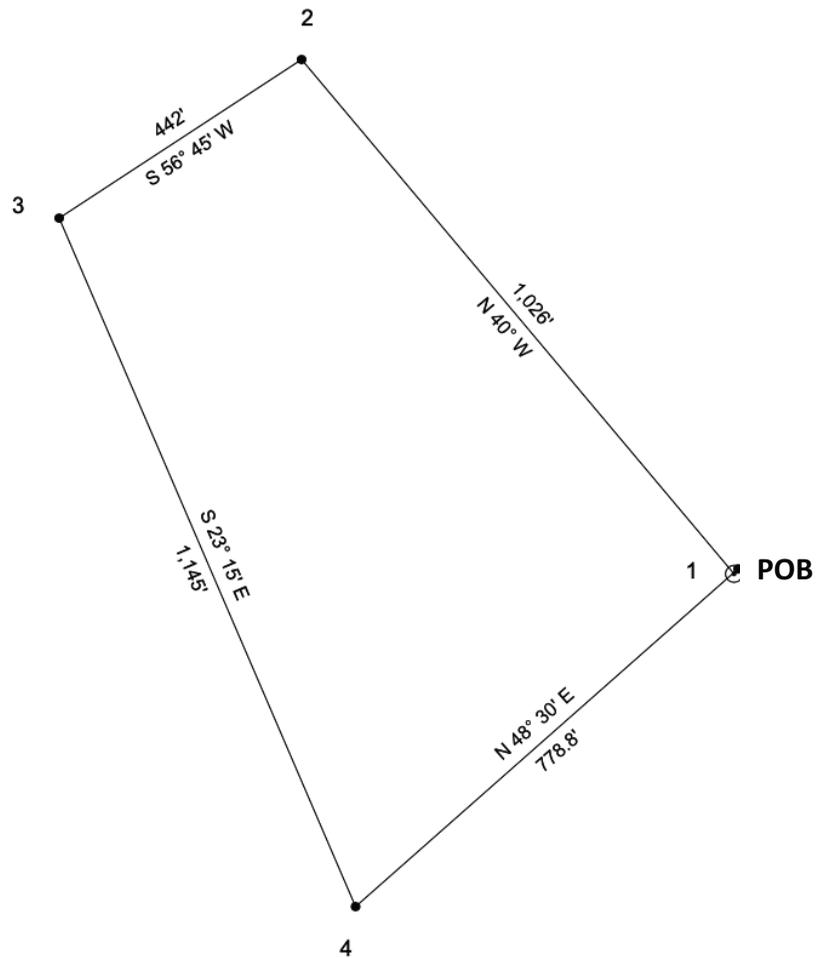
<sup>2</sup>Washington, G. (1750) *Plat of survey for John Lindsey of 223 acres in Frederick County, Va.* [Map] Retrieved from the Library of Congress, <https://www.loc.gov/item/99466768/>.

A metes and bounds description usually contains formal and antiquated language, map directions and degrees what refer to angles.

Here's another example of a typical metes and bounds description.

“Beginning at a point 1200 ft north 40° west from the southeast corner of the Asa Stone donation Land Claim No. 49,

thence north 40° west 1026 ft to a pipe,  
thence south 56° 45' west 442 ft chains to center of the road,  
thence south 23° 15' east 1145 ft,  
thence north 48° 30' east 778.8 feet to POB.”



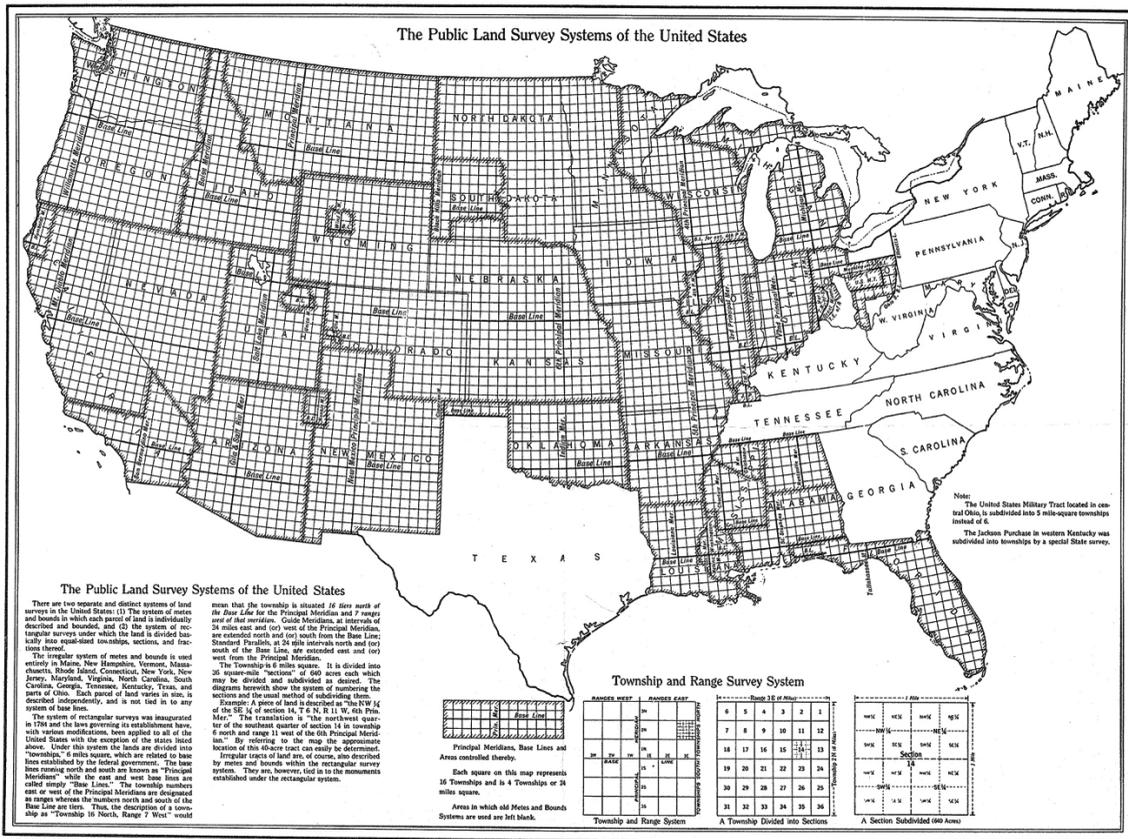
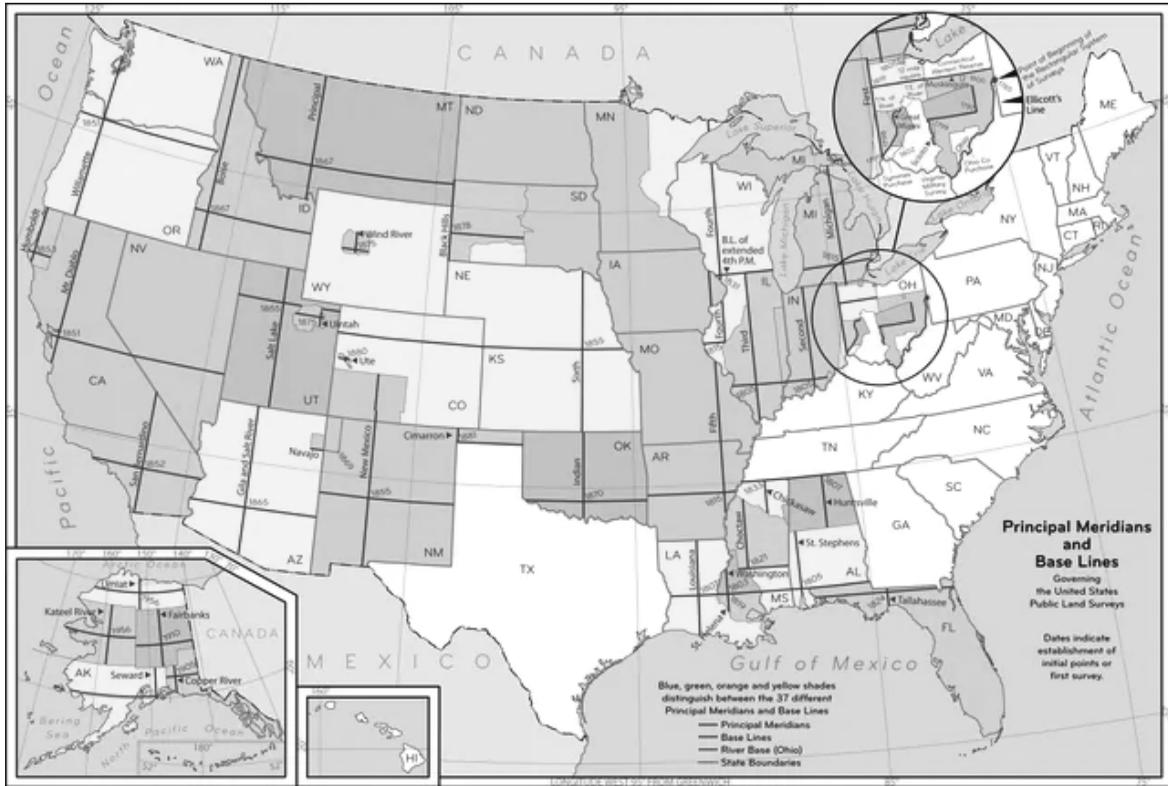
## *Rectangular / Government Survey*

The **Rectangular or Government Survey System** was created by the Land Ordinance of 1785 to survey land ceded to the United States by the Treaty of Paris in 1783. According to “A History of the Rectangular Survey System,” written by C. Albert White for the U.S. Department of the Interior, Bureau of Land Management, after the Revolutionary War, “Congress under the Confederation was deeply in debt to France and other creditors. Millions of dollars in continental bills and treasury notes were outstanding and Congress had no power to levy taxes on the land or States. The Northwest Territory loomed as the only asset the new country had which might be turned into hard money. If the vast public domain could be sold to settlers, it could return millions of dollars to the treasury and solve the pressing immediate need for money.”

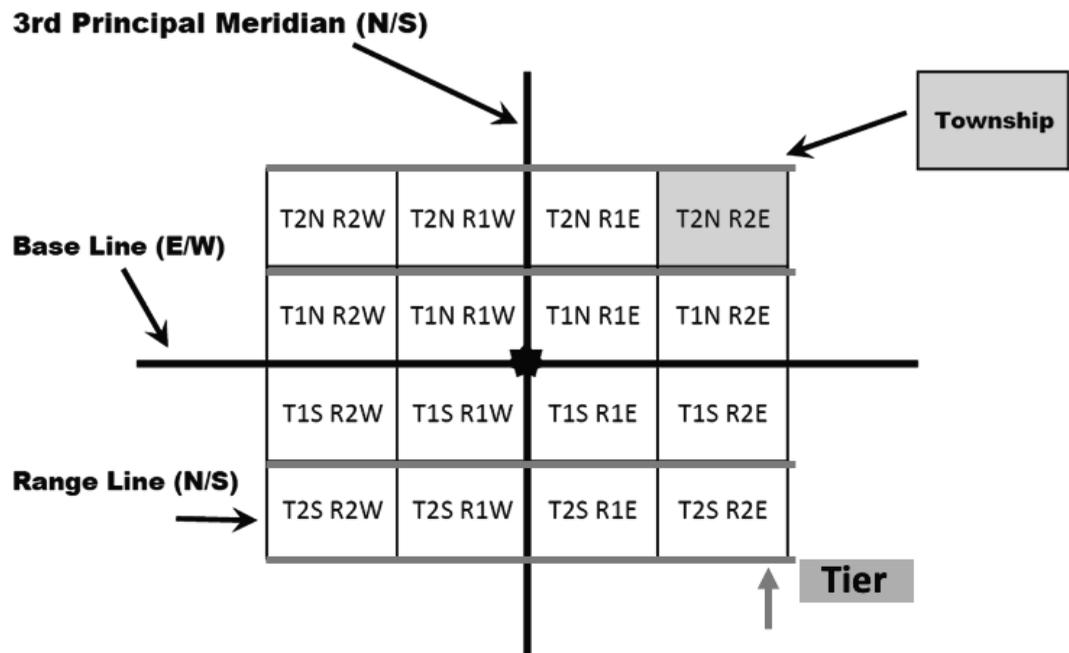
While some supported selling land to individual settlers in small parcels (advocated by John Adams and Thomas Jefferson), others believed individuals were neither intelligent enough nor capable of doing so and instead argued for large land grants to companies or wealthy men who would then handle the surveying and patenting. The Jefferson group proposed “a system of rectangular survey before any sale or settlement, with land to be sold at auction with a minimum price and in small parcels, giving everyone a fair chance to acquire land. They argued that survey before sale was necessary to prevent overlapping claims and to simplify deeds and registering. A rectangular system would survey all the land, with no gaps or gores, make the buyer take the poor land along with the good land, and make every man’s land have a common boundary with his neighbor.” (White, 1926)

The Land Ordinance provided specific instructions to surveyors that allowed one to determine the location of a parcel anywhere in the United States (to a limited degree) by placing a line grid across the country and sectioning off land based on the intersection of these lines.

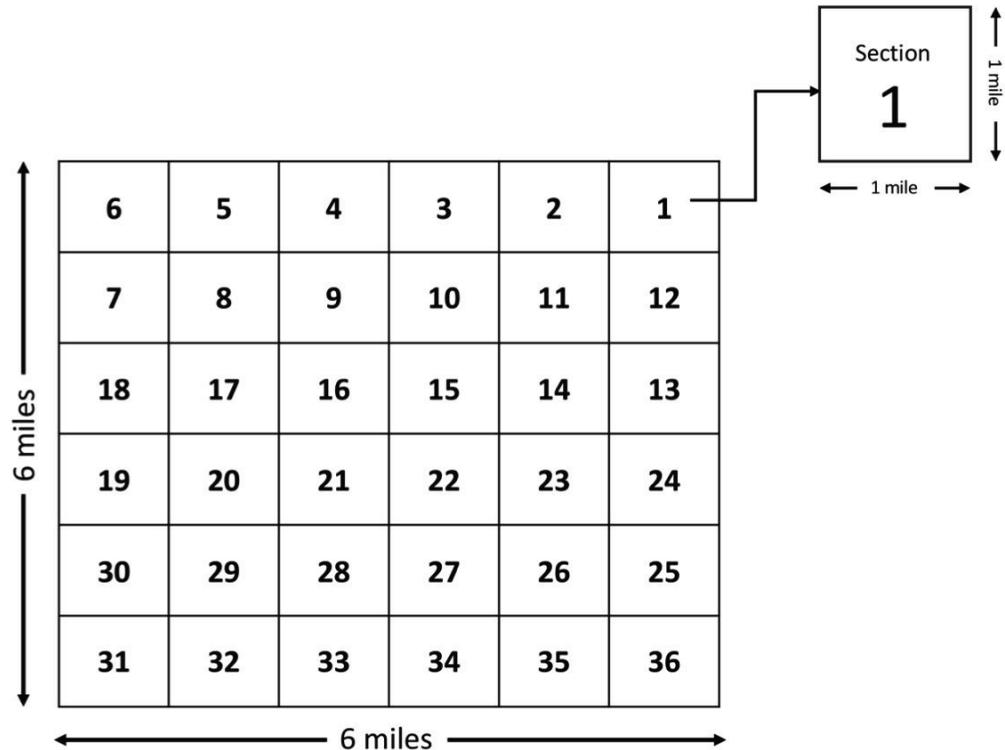
Thirty-seven principal **meridians** or north/south lines were strategically placed and named. Each parcel of land is described by reference to only one principal meridian. **Base lines**, which run east and west, can be found in nearly every state.



If you picture a spreadsheet where vertical lines are meridians lines and horizontal lines are base lines, then the rows and columns they create when they intersect are referred to as **ranges** (north/south columns) and **tiers** (east/west rows). As a helpful memory tool, the word “range” has five letters, just like the words “north” and “south,” where the word “tier” has four letters like the words “east” and “west.”



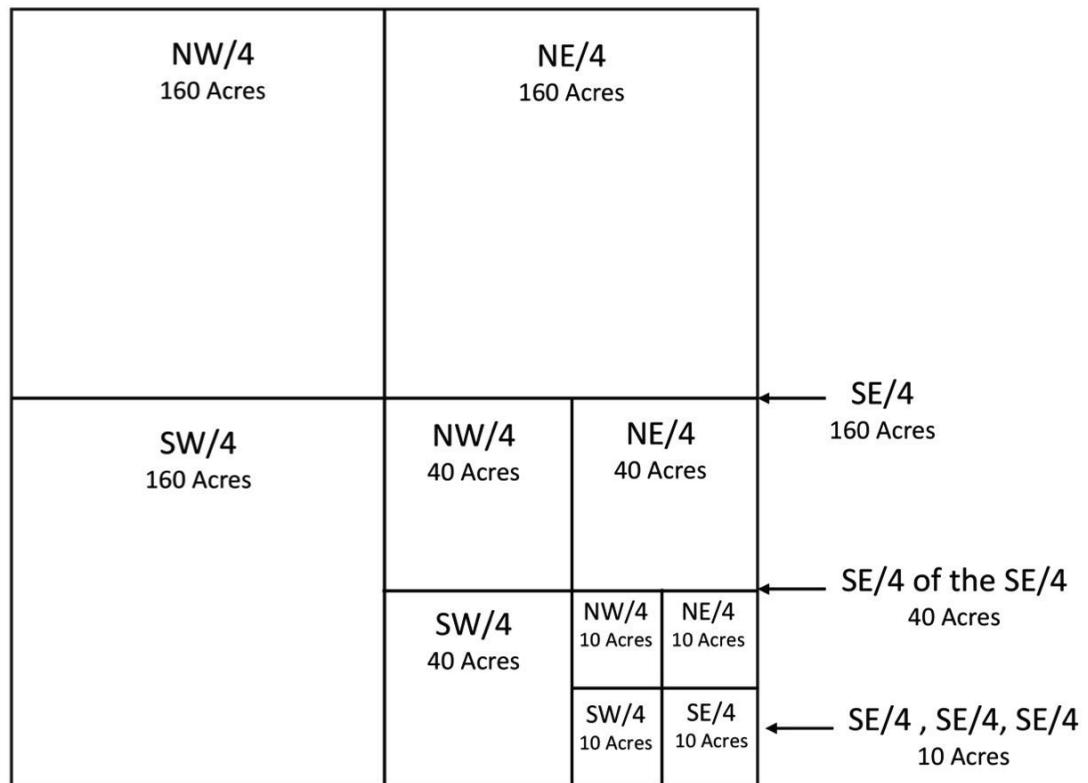
Each cell in this imaginary spreadsheet equates to a six-mile by six-mile square called a **township**. These are broken down even further into one-mile by one-mile **sections**, each containing 640 acres. Therefore, there are 36 sections per township. The numbering convention for these 36 sections winds like a snake. Sections 16 and 36 are set aside as **school sections**. The end result is a grid. Due to their uniform nature, sections are easy to locate. For example, the section northeast of Section 15 would be Section 11. North of Section 15 would be Section 10 and east of Section 10 is Section 11.



If a section contains 640 acres, how do we describe a smaller parcel within that section? Sections are divided into halves (320 acres) and quarters (160 acres), which can be halved and quartered again, multiple times to describe a specific parcel. Here's a common government/rectangular survey legal description:

“The SE 1/4 of the SE 1/4 of the SE 1/4 of Section 2 in Township 12 South, Range 61 West of the 6<sup>th</sup> Prime Meridian, County of El Paso, State of Colorado.”

To find this parcel, its recommended to start at the end of the description and move towards the beginning. Assuming the state and county, locate the 6<sup>th</sup> Prime Meridian and look for the township at Range 61 West and Tier 12 South. Within that township, find Section 2 then look in the southeast quarter. Dissect that quarter into four equal parts and look in the southeast or bottom right block. Then dissect that block into fourths and look in the bottom right.



Since the math is straightforward, to calculate the number of acres in a given rectangular survey system legal description, multiply all of the denominators and then divide the number into 640 acres.

For the SE 1/4 of SE 1/4 of SE 1/4 of Section 2,

multiply  $4 \times 4 \times 4 = 64$ .

Divide 640 total acres in the section by 64.

This parcel contains 10 acres.

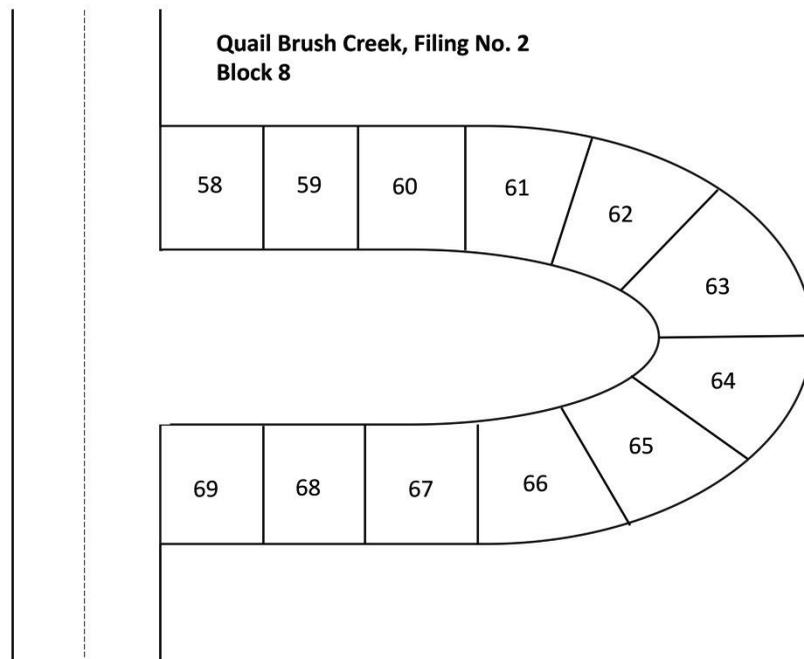
## ***Lot and Block (Recorded Plat)***

When a land developer subdivides a tract of land, a survey or **plat map** is recorded in the public records of the jurisdiction where the land is located. The plat shows the boundaries of each parcel of land. Each parcel of land is assigned a lot number and each group of contiguous lots is assigned a block number.

Since **lot and block** is usually a further refining of an existing parcel already legally described using rectangular/government survey or metes and bounds, the full legal description may be a combination of them. For example, when a developer records a plat map for the 30 lots, two parks and walking trails for his new subdivision, each lot's legal description will keep the rectangular or government survey description and then include a lot and block description as well.

A typical lot and block description may look like:

“Lot 62, Block 8, Quail Brush Creek Filing No 2, Colorado Springs, El Paso, Colorado”



## *Elevations*

Sometimes rights above the earth's surface need to be defined, for example when surveyors are developing floodplain maps or even property boundaries. In these cases, **datum** or a point or line from which elevations are measured, are utilized. New York Harbor is utilized by the United States Geological Survey as 0 or mean sea level, although not all cities utilize New York Harbor as their Datum Point.

Whatever point that is defined as datum must be detailed.

### **Math- Measuring Property**

#### *Measuring Structures*

When asked to measure a structure, say a two-story home, an appraiser (or licensee) usually does so by using the exterior measurements versus measuring each room and adding those measurements together. Different standards of measurement may be used. Garage space is not counted in square footage calculations. Total square footage should include both finished and unfinished areas. Living area (heated living area) is space that is intended for human occupancy. Many measurement standards do not count basements (even if they are finished), because in different parts of the country, basements are not intended for human occupancy. If the basement is counted, it would be listed separately as "below grade." Finished attic space with at least seven (7) feet of clearance may be counted in square footage measurements.

In commercial properties, usable and rentable areas are considered. **Usable** square footage is the actual space that is occupied wall-to-wall, excluding common building areas such as lobbies or bathrooms. When renting an entire floor, all amenities on that floor are included. **Rentable** square footage is the usable square footage plus a portion of the building's shared space. A tenant's rent is almost always calculated based on Rentable Square Footage. The increase in the rentable square footage above the usable square footage is referred to as either load factor, common area factor or add-on factor.

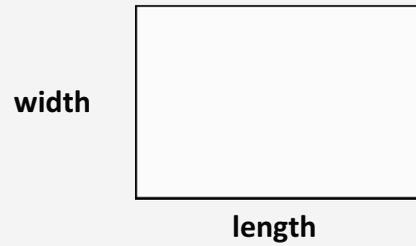
## ***Measuring Land***

Calculating the size of a land parcel, especially one of uneven shape, can be challenging. Here are common math units of measure to remember:

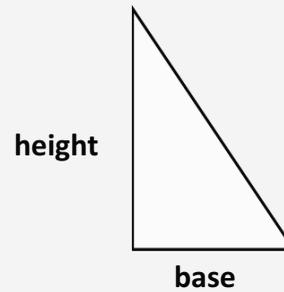
<b>Linear Measurements</b>	12 inches = 1 foot 36 inches = 3 feet = 1 yard 5,280 feet = 1,760 yards = 1 mile
<b>Square Measurements</b>	144 square inches = 1 square foot 1296 square inches = 9 square feet = 1 square yard To convert square feet to square yards, divide sf by 9 To convert square yards to square feet, multiply sf by 9
<b>Cubic Measurements</b>	1,728 cubic inches = 1 cubic foot 46,656 cubic inches = 27 cubic feet = 1 cubic yard To convert cubic feet to cubic yards, divide cf by 27 To convert cubic yards to cubic feet, multiply cf by 27
<b>Surveyor's Measurements</b>	43,560 square feet = 1 acre 640 acres = 1 square mile = 1 section 36 sections = 1 township 1 township = 36 square miles

### ***Calculating Area***

Rectangle: Area = Length x Width



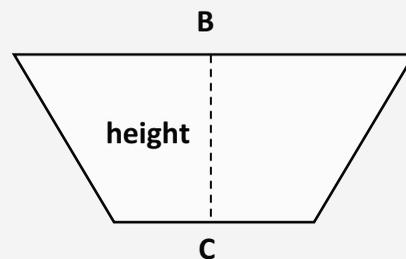
Triangle: Area =  $\frac{1}{2}$  Base x Height



Trapezoid: Area =  $[(B + C) \div 2] \times H$

A trapezoid is a four-sided figure which has two sides parallel to each other, and two equal sides which are not parallel to each other. The area of a trapezoid is the average length of the two parallel sides times the height.

Area =  $(B + C) \div 2 \times H$

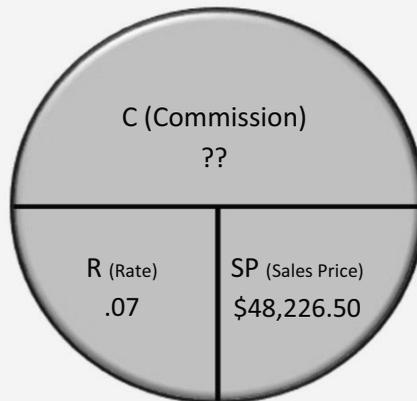


### **Sample Problem 1**

Bob Broker has listed a triangular lot with a frontage of 122'. It is 134' at its deepest point. If the lot sells for \$5.90 per square foot, how much will Bob earn if his commission is 7%.

#### **Solution:**

1. Calculate the lot's square footage.
2. Width (122) x Height (134) ÷ 2 = 8,174 square feet
3. Calculate the total price.  $\$5.90 \times 8,174 = \$48,226.50$
4. Calculate the commission. Apply the CRiSP Circle formula.



$$\text{Sales price } (48,226.50) \times \text{commission rate } (7\% \text{ or } .07) = \$3375.86$$

### **Sample Problem 2**

What is the cost of a lot 594' x 660' at a price of \$800 acres.

#### **Solution:**

1. Calculate the lot's square footage.
  - a. Width (594) x Height (660) = 392,040 square feet
2. Divide by the number of square feet in an acre.
  - a.  $392,040 \div 43,560 = 9$
3. Calculate the price.  $9 \text{ acres} \times \$800/\text{acre} = \$7,200$

### **Sample Problem 3**

Building codes require that the land be three times the size of any improvement. How many whole acres would your client need to purchase to accommodate a 20,000 square foot improvement?

#### **Solution:**

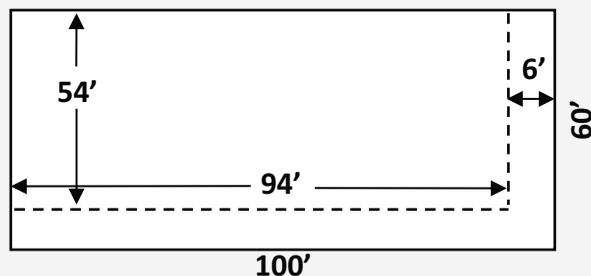
1. Calculate the minimum land size.
  - a.  $20,000 \times 3 = 60,000$  s.f.
2. Divide by the number of square feet in an acre.
  - a.  $60,000 \div 43,560 = 1.377410468319559$
3. Round up. The answer is a minimum of 2 acres.

### **Sidewalks**

A variation on area problems is the calculation of the surface area of a **sidewalk**. There are two types of sidewalk problems: a sidewalk “outside” the lot and a sidewalk “inside” the lot. Both can be solved using one basic method. Quiz questions will typically refer to a corner lot and the sidewalk will be on two sides of the lot.

### **Sample Problem 4**

What is the area of a 6' wide sidewalk installed inside a 60' x 100' corner lot?



**Solution:** Picture this problem as two overlapping rectangles: a larger one (60 x 100) which is the entire lot and a smaller one (54 x 94) which is the remainder of the lot after the sidewalk is constructed. The area of the sidewalk is the difference between the areas of the larger and smaller rectangles.

1.  $60' \times 100' = 6,000 \text{ s.f.}$
2.  $54' \times 94' = 5,076 \text{ s.f.}$
3.  $6,000 \text{ s.f.} - 5,076 \text{ s.f.} = 924 \text{ square feet}$

Problems asking you to figure the outside dimensions of a lot are figured in a similar fashion except that you will be adding the “sidewalk” dimensions to the size of the lot.

---

## Personal Property

---

The basic definition for **personal property** is anything that is not real property. Also called **chattels**, personal property would be anything not permanently affixed to real property with the intent to be permanent. In a residential transaction, appliances like refrigerators, washers and dryers are examples of personal property.

Personal property items are sometimes included in the rental of real property. For example, a hair salon wants to rent commercial space in a strip mall. To conduct business, the owner needs to install barbers' chairs, mirrors, hair washing sinks and display cabinets. These personal property items owned by the tenant and temporarily attached to real estate to conduct business are called **trade fixtures**. If trade fixtures are left by the tenant after the lease expires, they become the landlord's property.

Another exception are **emblems** or growing plants or crops, which are also considered personal property. Usually, plants that require human intervention and need to be replanted each year such as crops or gardens are considered personal property. Plants that don't require human intervention, such as perennial bushes, trees or shrubs, are considered real property.

## *Defining Fixtures*

Personal property is considered real property when it has been permanently attached to the real estate, whether that's lighting fixtures, toilets, or sprinkler systems. Legally speaking, the following test can be used to determine whether something is a **fixture** (and therefore real property) or simply personal property.

- **Method of Annexation** – How permanent is the method of attachment? Can the item be removed without causing damage? A bookcase leaning against a wall is personal property, as it hasn't been attached. A bookcase screwed into the wall for stability could potentially be removed easily and the holes patched. But a bookcase built into a wall, where the wall surrounding it is framed, drywalled and painted, is permanent.
- **Adaptability** – How has the item been adapted to the real property around it? Consider high-end refrigerators that have been adapted to match the rest of the kitchen cabinetry may be considered a fixture, not personal property.
- **Intention** in placing the item on the property - Was it the seller's intention that the item in question be removed (personal property) or stay (real property)? If a seller remodels a bathroom and hangs a decorative, framed mirror rather than installing a mirrored medicine cabinet, he or she may intend to leave the mirror as if it was permanently attached.
- **Agreement** of the parties – Have the parties agreed on whether the item is real property or personal property in the contract for sale or lease? This is the most important test. What does the contract say?

A ceiling fan in its box, sitting on the floor in a living room, is personal property. Once it is installed, it is said to be **affixed** and therefore

converted from personal property to real property. On the other hand, when a ceiling fan is taken down and put in a box, it has been severed (**severance**) and converted from real property back to personal property.

Personal property is not assumed to be included in the transfer of real property. The sales contract should clearly define which property is considered real property and which property is considered personal property. Personal property is usually transferred by a **bill of sale**.

# Chapter 4 Key Point Review

---

1. Land – the surface, all natural things attached to the surface, below the surface to the center of the earth, and the airspace above the surface to infinity.
  - a. Subsurface rights – Resources below the earth’s surface.
    - i. May be sold or leased separately from the surface rights.
    - ii. Transferred by Deed.
  - b. Air rights – the rights to use the space above a parcel of land.
    - i. May be sold or leased separately from the surface rights.
    - ii. Transferred by Deed.
    - iii. May be limited by fly-zones for airports, military, etc.
  - c. Water rights – rights surrounding water beneath, across or adjacent to land.
    - i. Rights handled differently on whether the water is a river, lake or ocean.
    - ii. Water may be regulated by the state in water-critical areas.
    - iii. Riparian Rights – pertaining to rivers and streams.
      1. If a river is navigable, property owners own land to the water’s edge.
      2. If a river or stream is non-navigable, property owners own the underlying land to the midpoint of the stream or river.
      3. Ownership of the land may not actually include the right to use the water.
    - iv. Littoral Rights – pertaining to lakes, oceans, and seas.
      1. Owners enjoy use of these waters.
      2. Ownership extends only to the high-water mark, or the highest level the water reaches over the land.
      3. The water is considered a public easement.
    - v. Doctrine of Prior Appropriation – water is controlled by the state.
      1. Found in states that are water critical.
      2. Landowner must demonstrate to the state a need for use.
      3. Priority of the water is usually determined by the oldest recorded permit issued by the state.
    - vi. Water can create:
      1. Erosion – gradual loss of land as water wears it away.
      2. Accretion – the addition of land as water deposits soil.
      3. Avulsion – the dramatic tearing away of soil via a natural disaster.

- d. Physical and Economic Characteristics of Land
  - i. Physically characterized as:
    - 1. Immobile – location can never be changed.
    - 2. Indestructible – the land survives (even in the case of wildfire)
    - 3. Unique (Non-homogenous) – No two parcels are exactly the same.
  - ii. Economically characterized as:
    - 1. Scarcity – the total of land is finite.
    - 2. Permanence of Investment – adding improvements can dramatically increase value.
    - 3. Area Preference (Situs) - Location, location, location.

## 2. Legal Property Descriptions

- a. A detailed way of describing land required for deeds, easements, and mortgages.
- b. Considered legally sufficient if it allows a surveyor to locate the parcel.
- c. Usually based on information collected through a survey.
- d. Three methods of legally describing real estate:
  - i. Metes and Bounds
    - 1. Describes the perimeter of a property using landmarks, monuments, distances and angles.
    - 2. Metes – Measurement of length
    - 3. Bounds – Boundaries
    - 4. POB – Point of Beginning
    - 5. Is considered incomplete unless it returns to the POB.
  - ii. Rectangular or Government Survey System
    - 1. A method that allowed surveyors to determine the location of a parcel anywhere in the United States by place a line grid across the country and sectioning off land based on the intersection of those lines.
    - 2. Principal Meridians – north/south lines
      - a. 37 total Principal Meridians
      - b. Each parcel of land is referenced to only one Principal Meridian.
    - 3. Base Lines – east/west lines
      - a. Intersect Principal Meridians
    - 4. Ranges – north/south columns
    - 5. Tiers – east/west rows
    - 6. Township – intersection of Ranges and Tiers
      - a. Six miles by six miles square
      - b. Made up of 36 Sections.

- c. Sections numbered from right (1) to left (6) and winds like a snake ending with Section 36 in the lower right of the Township.
    - d. Sections 16 and 36 are set aside as School Sections.
  - 7. Sections
    - a. One mile by one mile
    - b. 640 acres
  - 8. Sections can be broken down into smaller parts. ( $1/4$ 's,  $1/2$ 's) and those smaller portions can be halved and quartered again multiple times.
  - 9. Calculating a parcel size in a Section can be done by dividing 640 by the denominators that are represented in a legal description.
    - a. NW/4 of the NE/4 of the NW/4 of Section 12
    - b.  $640 \div 4 \div 4 \div 4 = 10$  Acres
- iii. Lot and Block (Recorded Plat)
  - 1. Utilized when a developer subdivides a plot of land.
  - 2. A survey plat is recorded in the public records showing the boundaries of each parcel of land.
  - 3. Each parcel is assigned a lot number.
  - 4. A group of contiguous lots may be assigned a block number.
- e. Elevations
  - i. Utilized when rights above the earth's surface need to be defined.
    - 1. Utilized for floodplain maps, property boundaries, condominiums.
  - ii. Datum – a point or line from which elevations are measured.
    - 1. Originally was measured from New York Harbor
    - 2. Not all cities and states use New York Harbor as their Datum point.
    - 3. Whatever is used must be defined.

### 3. Personal Property

- a. Anything that is not Real Property.
- b. Also called Chattels.
- c. Not permanently affixed to real property with intent to be permanent.
- d. Trade Fixtures – personal property items owned by a tenant and temporarily attached to real estate to conduct business.
  - i. If left by the tenant after the lease expires, they become the landlord's property.

- e. Emblements – Growing plants or crops that require human intervention.
  - i. Considered personal property.
  - ii. Crops or gardens.
  - iii. Plants that don't require human intervention, such as bushes, trees or shrubs are considered real property.

#### 4. Fixtures

- a. Considered Real Property
- b. Personal property that has been permanently attached to the real estate.
  - i. Lighting fixtures, toilets, sprinkler systems, etc.
- c. Legal tests if something is a fixture.
  - i. Method of Annexation
    - 1. How permanent is the item?
    - 2. Can it be removed without causing damage?
  - ii. Adaptability
    - 1. How has the item been adapted to the real estate around it?
  - iii. Intention
    - 1. What is the Seller's intention for the personal property?
  - iv. Agreement
    - 1. What have the parties agreed to?
    - 2. This is the most important criteria. What does the contract say an item is.
- d. An item of personal property that is installed or attached is said to be affixed.
- e. A Fixture that has been removed and turned into personal property is said to have been severed. (Severance)
- f. Personal property is not assumed to be included in the transfer of real property.
  - i. The sales contract should clearly define which property is considered real property and which is considered personal property.
- g. Personal Property is transferred by a Bill of Sale.
- h. Fixtures (Real Property) is transferred by a Deed.

# Chapter 4 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. Fixtures are automatically included with real property.
2. Land specifically refers to the surface and all natural things attached to it, but not what's below the surface or the airspace above it.
3. Subsurface includes the dirt, rocks, minerals, gas, oil, and water below the land.
4. Subsurface rights, or rights to the resources below the earth's surface, may be sold separately from the surface rights or they may be leased to others.
5. Air rights may not be sold or leased separately from the surface rights.
6. Riparian water rights describe rights for properties next to large bodies of water.
7. If the river is navigable, property owners own land to the water's edge.
8. If the river or stream is navigable, then property owners own the underlying land to the midpoint of the stream or river.
9. Littoral rights give properties on lakes the right to enjoy those waters up to the low-water mark.
10. Littoral rights refer to those given to properties that abut to seas or oceans.
11. After Hurricane Katrina, caused existing bodies of open water to be enlarged and fringing marsh areas to be reduces. This is an example of erosion.
12. Accretion is the addition of land as water deposits soil.
13. Building an improvement on a parcel of land rarely changes its value.
14. A plot of land's location is usually not a purchaser's primary concern.
15. A section contains 36 townships.
16. A section contains 640 acres.
17. A parcel of land described as W/2, SW/4, NW/4 of T8S, R14W, of the 6<sup>th</sup> Principal Meridian has 20 acres.

18. Section 8 is directly north of Section 16 in a township.
19. A prize-winning rose bush is an example of real property.
20. House keys are an example of a fixture.
21. A custom-built freestanding bookcase is an example of chattel.
22. Chattel is real property.
23. Trade fixtures are fixtures that are attached to real property.
24. Emblements are also known as crops and are personal property.
25. Annexation, Adaptation, and Agreement are the legal tests of a fixture.
26. Land is indestructible, immobile and never depreciates.
27. Metes and bounds legal descriptions use plat maps and are used in urban areas.
28. Monuments, points of beginning, and measurements are used with metes and bounds legal descriptions.
29. Rectangular survey is also known as government survey.
30. Ranges and meridians run north and south.
31. Tiers and base lines run north and south.
32. A township is six miles squared and has 36 sections.
33. One acre has 12,560 square feet.
34. The Doctrine of Prior Appropriation states that water rights are determined by priority of beneficial use.
35. Air rights, surface rights, and subsurface rights are part of real property.
36. A legal description may be based on information collected through an easement.
37. Sections 16 and 36 are set aside as school sections.
38. A datum is a point or line from which elevations are measured.

39. Garage space is not counted in square footage calculations.
40. When affixed, a ceiling fan converts from personal property to real property.
41. Through severance, a ceiling fan converts from personal property to real property.
42. Chattel transfer from one owner to another on a deed.
43. An owner decided to fence his 80' square lot. He will need 32 posts if starting at one corner and one post is placed every 10'.
44. If a man sells six acres of prime, undeveloped property to a woman for \$2.25 per square foot, she paid \$612,360.
45. The annual rent per square foot for a 30' x 40' office space that rents for \$2,950 per month is \$29.50.
46. If a 10-acre lot sells for \$425,000, a similar 7-acre lot would sell for \$297,500.



# 5 Property Ownership

**Real Estate versus Real Property**

**Deeds**

**Ownership Rights**

**Types of Ownership**

**Common Interest Ownership Properties**

**Encumbrances**

---

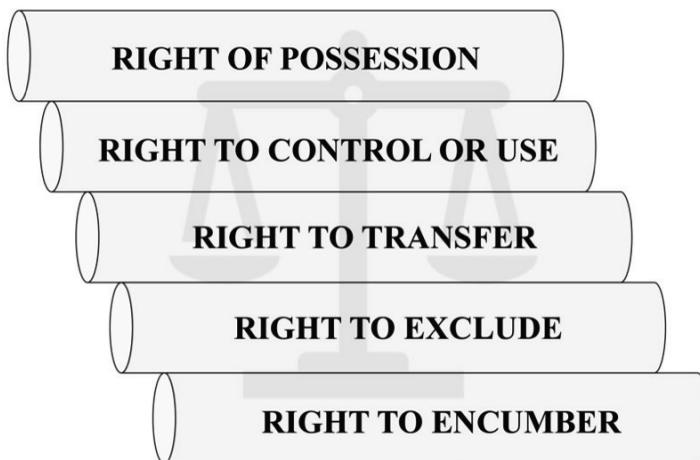
## **Real Estate versus Real Property**

---

The next term to define is **real estate**, which takes the previous definition of land and adds manmade permanent **improvements** like a house or a fence. Compared to real estate, **real property** is land, improvements, **attachments** and the **legal rights** attributed to the ownership of that real estate. Granted, licensees often use the terms “real estate” and “real property” interchangeably; they could be considered synonyms depending on the state.

Ownership rights included with real property are described as a **bundle of legal rights**. They include:

- **Right of Possession** – where possession means the right to occupy.
- **Right to Control or Use** - doing with the property those activities allowed by law.
- **Right to Transfer** - to sell, will, transfer, etc.
- **Right to Exclude** - to keep others from entering or using the premises.
- **Right to Encumber** - to place liens or provide non-possessory interest to someone else.



Property owners can keep all their rights or give certain rights to others. For example, an owner gives up his or her rights of possession and use to a tenant when the property is leased.

---

## Deeds

---

One's ownership in real property is evidenced by a conveyance deed, which is an actual piece of paper that documents the owner(s), the type of ownership, the legal description of the real estate and more. The legal concept of ownership to real property is called title. An owner must use some form of written deed to transfer title to another owner. The owner conveying title is the grantor (seller). The recipient is the grantee (buyer). Title passes from the grantor when the executed (signed) deed is delivered to and accepted by the grantee.

**Quick Break – Suffixes**

The language of real estate contains many legal terms. For example, to “grant” means to transfer ownership of real property. By adding “-or” to the end of grant, the word “grantor” means the giver (remember *givor*) of the grant of ownership. Likewise, adding “-ee” at the end of “grant” forms “grantee” or the receiver (remember *receever*) of the grant of ownership. These suffixes are common throughout this text, making it easy to determine who is the giver and who the receiver of something. See Appendix C for an -ee/-or chart.

There are several types of deeds that convey title, each with varying warranties or promises made by the grantor.

PRIMARY DEEDS			
GENERAL WARRANTY DEED	SPECIAL WARRANTY DEED	BARGAIN & SALE DEED	QUIT CLAIM DEED
Provides the most protection for the buyer.  Most responsibility for the seller.  Broadest form of guarantee of title.  Seller provides all covenants for all time.	Provides less protection for the buyer  Seller provides and guarantees all covenants but only during the time they held title.	Seller makes no warranties.  Only implies the grantor holds the title and is legally able to convey it.  Mostly used as sheriff’s deeds, tax deeds, trustee’s deeds.	Conveys any interest but doesn’t claim that the is any.  Used to clear up clouds on title from incorrect deeds, divorces, inheritances, etc.  Can be utilized to create easements and clean up encroachments.

A **general warranty** deed is said to provide the greatest protection for the grantee because it commits the grantor to make the most covenants (promises).

- **Covenant of seisin** – the grantor owns the property and has the right to convey it.

- **Covenant against encumbrances** – the grantor warrants that the property is free from any liens or encumbrances except those specifically stated in the deed.
- **Covenant of quiet enjoyment** – the grantor guarantees that the grantee won't be disturbed by a third-party claiming ownership.
- **Covenant of further assurance** – the grantor promises to obtain and deliver any instrument required to make the title good against third party claims in the future.
- **Covenant of warranty forever** – the grantor promises to obtain and deliver any instrument required to make the title good against third-party claims even if those claims originated during a time when the grantor didn't own the property.

With a **special warranty** deed, the grantor warrants that the property was not encumbered during the time that the grantor held title, except as noted in the deed; the covenant of warranty forever is removed. A **bargain and sale** deed states that the grantor warrants that the title is valid but may or may not warrant against encumbrances nor promise to defend against claims by the other parties.

Finally, a **quitclaim** deed contains no warranties or promises at all and conveys only such interest, if any, that the grantor may have when the deed is delivered but conveys that interest completely. Quitclaim deeds are often used to cure a **defect** in title, also called a **cloud on the title**. An example would be a recorded mortgage that had been paid in full but for which a satisfaction of mortgage was never recorded. Sometimes a **suit to quiet title** or court action is needed to cure a cloud or gap in the chain of title.

A deed must contain the following **essential elements** to be valid:

1. **Grantor** (seller) must be of legal age and be legally competent to convey the title (18, sane and sober).
2. **Grantee** (buyer) – must be named in the deed in such a way that he or she can be identified. Note that grantees do not have to be of legal age.
3. **Consideration** – something of value that must be acknowledged by the grantor. Most states require consideration to be stated in a dollar amount.
4. **Granting clause** – must contain words that state the grantor's intention to convey the property.

5. **Habendum clause** - follows the granting clause when necessary to define the terms of ownership to be enjoyed by the grantee, including the type of freehold estate (covered in the Ownership Rights section of this chapter) being granted.
6. **Description of real estate** – must use a legal description that is understood by all parties.
7. **Signature of grantor** – must be signed by all grantors named in the deed. The grantee does not need to sign the deed.
8. **Delivery and acceptance** – actual delivery of the deed by the grantor and either actual or implied acceptance by the grantee.

**Acknowledgment** (notarization) provides evidence that the grantor's signature is valid, voluntary and genuine. Some states require acknowledgment for a deed to be valid.

Title passes to the grantee when the executed deed is delivered to and accepted by the grantee. Imagine a grantor has signed a deed but instead of delivering it to the grantee, he instead puts it in a shoe box in his closet. Has title transferred? No.

A deed does not need to be recorded to be valid, however it is in the grantee's best interest to do so. Recording a deed or taking possession of the property gives **constructive notice** to the world that one has rights in the property.

To be transferable, the title must be **marketable** or **merchantable**. This means the **chain of ownership** (title) to a particular piece of property is clear and free from defects or clouds. Envision each owner of a property as a link in a chain, starting with the earliest recorded owner to the present. A break in the chain of ownership would create a gap that would require additional effort by the seller or potential buyer to clear, as ownership during that period is uncertain and unknown.

---

## Ownership Rights

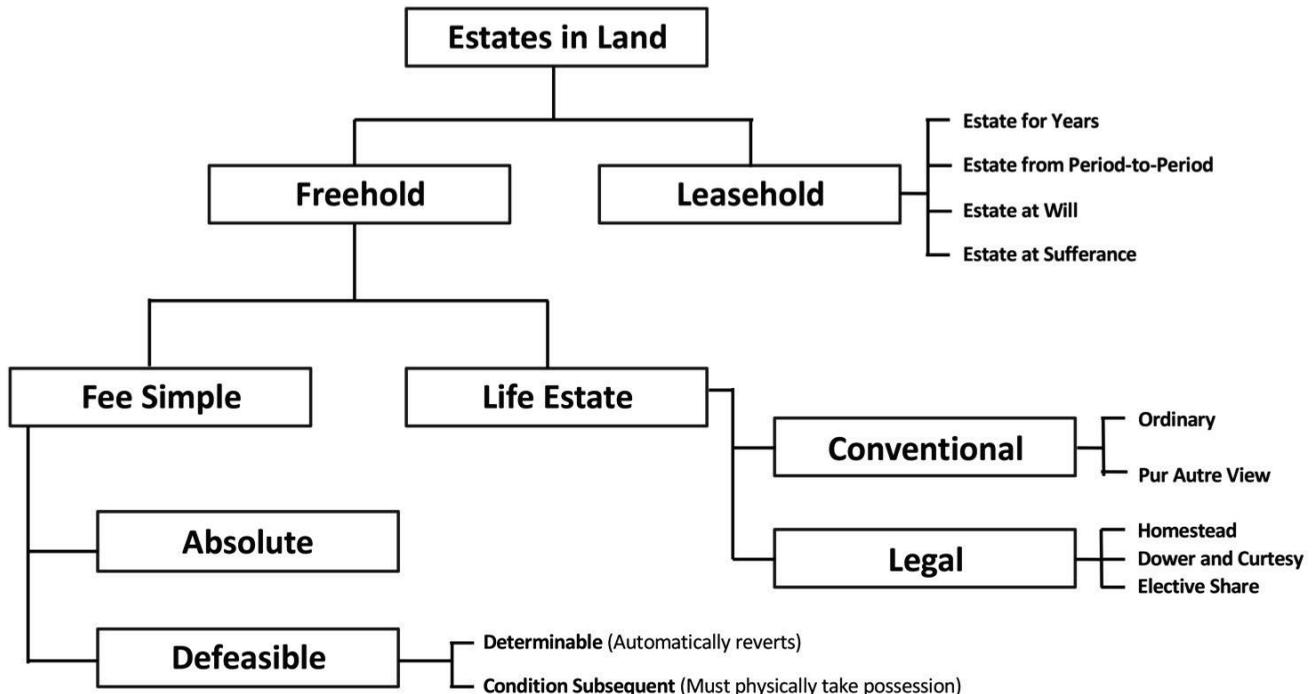
---

When discussing a real property's bundle of legal rights, ownership of any combination of those rights indicates an **interest** in that property. If someone owns the right of possession (the right to occupy the property) he or she has a possessory interest. If someone has given up the right to occupy the property, then he or she has a non-possessory interest. Those with a possessory interest are said to have an **estate in land**.

### *Freehold Estate*

First, one can have a **freehold** estate, where the owner's rights last for an indeterminable length of time. An owner with a freehold estate can hold onto that property until death and bequeath those rights to their heirs or sell those rights (and the property) as soon as they acquire them. There's no stipulation on how long those rights must be held.

Freehold estates come in several flavors.



A freehold estate can be classified as **fee simple** if it includes all of the rights in our legal bundle (possession, use, transfer, encumber and exclusion) or a **life estate**.

There are two different types of fee simple estates – fee simple absolute and fee simple defeasible. **Fee simple absolute** is the highest interest in real estate recognized by law where the owner is entitled to all the rights of the property. Those legal rights can pass to heirs through a will or laws of descent. **Fee simple defeasible**, on the other hand, means the owner's interest is subject to the occurrence or non-occurrence of an event. We say those rights can be defeated if something does or doesn't occur.

A fee simple defeasible estate can be **determinable**, where if a usage condition stated on the deed is violated, the subsequent owner could lose their rights, which would automatically revert to the grantor or to the grantor's heirs. The grantor does not have to physically take possession of the property. For example, a plot of land is transferred to a church as long as the church uses it for non-profit purposes. If the church puts a car wash on the land, the ownership of the land would automatically be transferred back to the grantor.

Additionally, a fee simple defeasible estate can be **condition subsequent**. In this scenario, if a condition is violated the subsequent owner may have a right to reclaim the property but would have to bring a court action to do so. The grantor would also have to physically re-possess the property. The above example could also be a condition subsequent. The difference is the process needed to reclaim the property.

**Life estates** are estates of ownership that are not inheritable. In a **conventional life estate**, the life tenant or the holder of the life estate, owns the property for the duration of the **measuring life** (or lives) only. The creator of the life estate may name a **remainderman** as the person to whom the property will pass when the life estate ends or establish a **reversionary interest** where ownership of the estate returns to the original owner, or their heirs, upon the end of the life estate.

Let's say that Mary owns property, and she wants to gift it to her disabled granddaughter for as long as her granddaughter is alive. At the time that the granddaughter (life tenant) dies, she wants the property to revert back

to herself. If she's no longer alive when her granddaughter dies, she has named her daughter to be the remainderman.

Life estates may also be based on the lifetime of a person other than the life tenant. This type of life estate is called **Pur Autre Vie** (for the life of another). Now, Mary sets her disabled granddaughter as the measuring life and her daughter owns the home until her granddaughter dies, at which time the property's ownership reverts back to Mary or could go to her husband as a remainderman.

Sometimes life estates are not created by a property owner but rather established by state law. These **legal life estates** are designed to protect family survivors. They include dower and curtesy, elective share and homestead.

- **Dower** (the right a widow has in property owned by her husband) **and curtesy** (the right a widower has in property owned by his wife) state that when one spouse dies, the other can make a claim to portions of the decedent's property.
- **Elective share** allows a surviving spouse to make a claim upon their deceased spouse's real and personal property, even if the survivor is not named in the decedent's will.
- **Homestead** rights protect the "family home" from general creditors attempting to collect on debts. The amount of the home's value that is protected from debtors (excluding mortgage holders and tax liens) is usually limited by a dollar amount (i.e., \$90,000). The homestead interest can't be conveyed by only one spouse, endures over the life of the head of household to his or her minor children, and are extinguished if the property is destroyed.

---

## Types of Ownership

---

Property may be owned by one individual alone or by a group of individuals in some form of concurrent ownership.

### *Individual Ownership*

If a single person or single entity has a freehold estate, it is a **tenancy in severalty** or **estate in severalty**. Sole ownership can be in the name of Mary Jones or XYZ Limited Corporation (regardless of the number of stockholders).

A **trust** provides a way for a person to transfer ownership of property to another to hold and/or manage for the benefit of third party. The **trustor** creates the trust, while the **trustee** manages the trust on behalf of a **beneficiary**. Profits earned by the trust and assets of the trust will be passed on to the beneficiary according to the instructions of the trustor. A **living trust** is created during the lifetime of the trustor. A **testamentary trust**, on the other hand, is created by a will upon the death of a trustor.

There are several types of partnerships that can also purchase property. In a **general partnership**, two or more people carry on a business venture as co-owners. General partners are entitled to participate in the management of the business. They are responsible for their share of the liabilities and entitled to their share of the profits. The general partnership will dissolve if a general partner dies, withdraws, or the partnership goes bankrupt.

In a **limited partnership** there are two types of partners – general partners and limited partners. There must be one or more **general partners** who are responsible for the partnership’s operation. The **limited partner(s)** have no voice in the management of the organization but are responsible for expenses and debts. The partnership agreement may provide for

continuation of the partnership after the death or withdrawal of one of the partners.

**Corporations** are considered an artificial person. They can buy, sell, own and borrow against a property. The corporation is made up of people who own stock in the company. It's run by an elected board of directors. The death of an officer or director does not terminate a corporation; it exists until it is formally dissolved.

A **Limited Liability Company (LLC)** combines both corporation and partnership attributes. It offers the tax advantages of a partnership; however, members of an LLC enjoy the limited liability of a corporation.

## *Concurrent Ownership*

When more than one person concurrently owns a property, their ownership can be either as tenants in common, joint tenants, tenants by the entirety or ruled by community property laws. In this context, tenants are NOT lessees. This is a legal term referring to co-ownership of a property.

If an interest in real property includes ownership of any combination of the legal bundle of rights, that interest is considered **undivided** among co-tenants. Therefore, all owners have the same rights, which can't be divided up or assigned to different co-tenants. For example, all owners have the right to mortgage the property together.

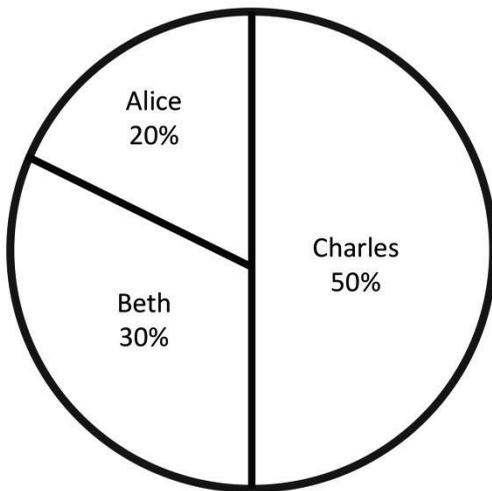
Ownership as **tenants in common** provides co-tenants **undivided interests** and any (unequal) **ownership share** is possible. Mona and Jane can both own 25% of the property while Cara owns the remaining 50%. Another important concept is the **right of survivorship**, which refers to the legal rights of those surviving after the death of a co-owner. Right of survivorship means the surviving co-owners absorb the rights of the owner who died. No right of survivorship means that if a co-owner dies, his or her ownership rights transfer to whomever is named in that person's will, not the surviving owners. Tenants in common (remember "to the children") do not enjoy the right of survivorship, therefore an owner can

convey or will their property to an outside party, who would also be tenants in common with the surviving owner(s).

## TENANCY IN COMMON

### CONVEYANCE

INITIAL INTERESTS

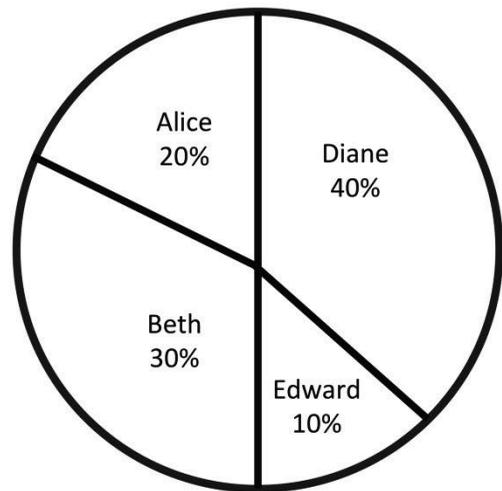


Charles  
sells to

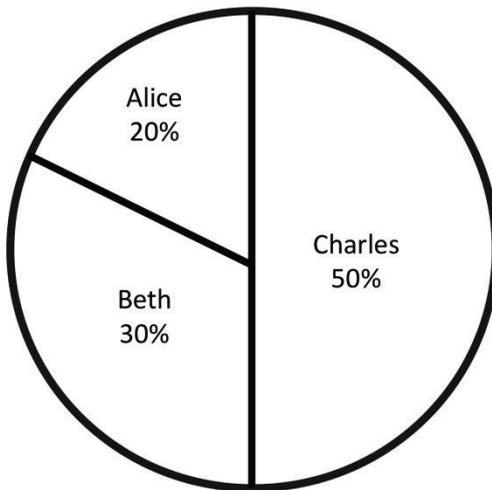


Diane and  
Edward

AFTER CONVEYANCE



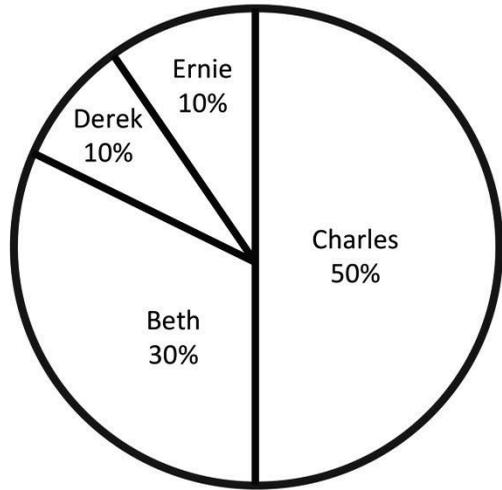
### TRANSFER UPON THE DEATH OF AN OWNER



Alice dies  
and wills  
to



Derek and  
Ernie



The second type of co-ownership is **joint tenancy** (remember “joined together”). Joint tenants have equal undivided interest and equal ownership shares. Two owners automatically have 50% ownership shares; three have 33.3%, etc.

What makes joint tenancy unique is that these co-owners do enjoy a right of survivorship. On the death of a joint tenant, interests and rights remain with the surviving joint tenants, not to any heirs, even if they’re named in the decedent’s will. If only one joint tenant is alive, the joint tenancy is terminated and his or her interest becomes an estate in severalty, meaning the property will go through **probate** when the surviving owner dies.

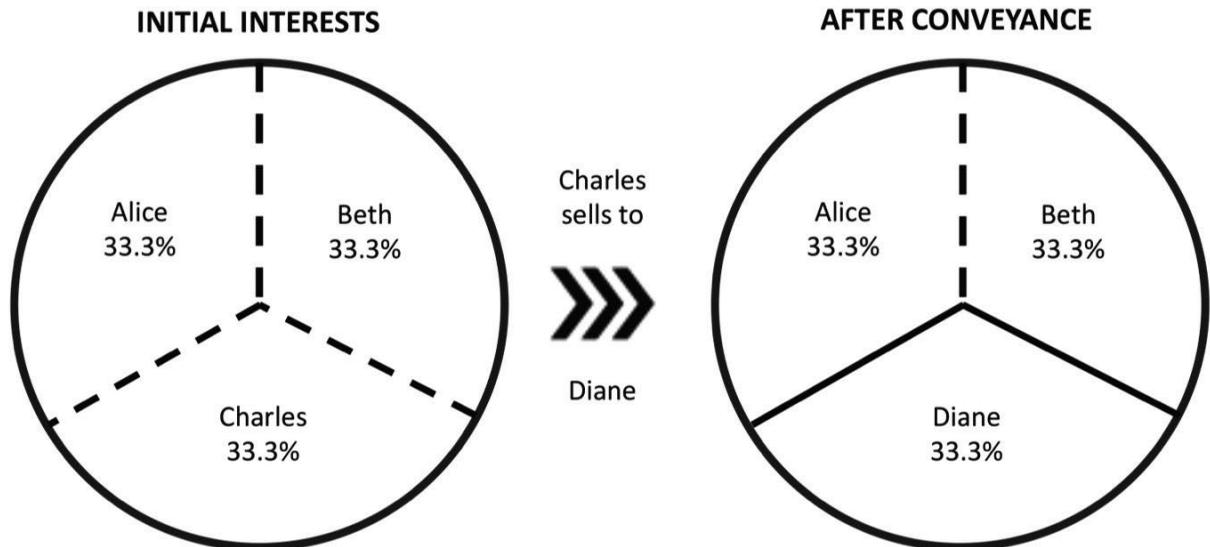
Joint tenancy is sometimes referred to as a “poor man’s will” because property owned this way doesn’t have to go through probate. It makes sense, then, that certain conditions must be met for joint tenancy to be allowed. These **unities of title** can be remembered as the acronym PITT and are:

- **Possession** – All joint tenants have an equal possessory right.
- **Interest** – All joint tenants have an equal ownership share in the property.
- **Title** – Joint tenancy is created on the same document (deed).
- **Time** – Joint tenancy of all parties is created at the same time.

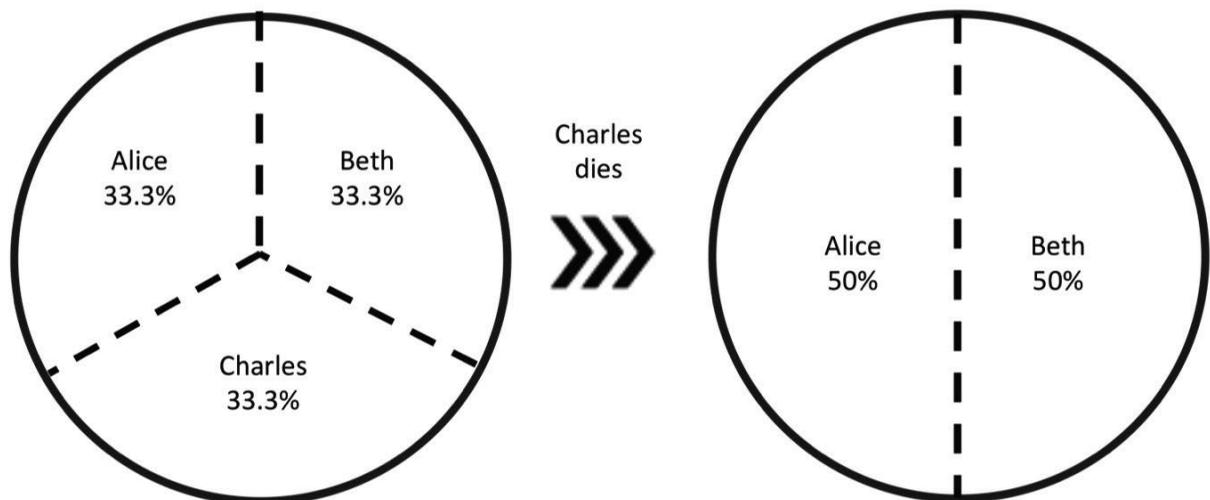
Any of the co-owners could sell his or her ownership share to a non-co-owner, however since that person would not have been on the title at the same times as the remaining co-owners, the new owner would be a tenant in common while the other co-owners remained joint tenants.

# JOINT TENANCY

## CONVEYANCE



## TRANSFER UPON THE DEATH OF AN OWNER



Some states still allow for another type of co-ownership specifically for married couples called **tenancy by the entireties**. Husband and wife (or in some states, domestic partnerships) own equal undivided interests and enjoy the right of survivorship, however neither spouse can act alone to sell the property.

Lastly, **community property** states classify property as either separate or community. Separate property covers real and personal property items acquired before the marriage (by gift or inheritance) with separate property funds or using income derived from a separate property. Separate property is owned individually. Community property is all other property earned or acquired during the marriage and is owned collectively by the married couple. Upon the death of one spouse, the survivor automatically owns one-half of the community property. The deceased spouse's share is passed on to their heirs. There is no automatic right of survivorship.

---

## Common Interest Ownership Properties

---

**Condominiums**, which can be residential, commercial or industrial, allow for multiple owners of individual units within a larger building. An owner owns a fee simple title to air rights in a specific unit and an undivided interest in common areas such as green spaces or lobbies as a tenant in common. For example, if a condominium contains 10 units, each owner owns his or her unit completely (fee simple) and a 1/10 share of the lobby, laundry facilities and walking trail. Each unit owner can sell or mortgage his or her property. Some condominiums implement a **right of first refusal** policy (indicated in their by-laws) whereby the owner must offer his unit for sale to the other unit owners before accepting an outside offer. If an owner defaults on his or her loan, no other unit owners are affected. Each property owner is individually taxed for his or her unit.

The condominium developer must file a **declaration** with the county that includes a legal description of the units and common areas, a copy of association **by-laws** and **restrictive covenants**, a survey and architectural drawings. Homeowners Associations (**HOAs**) carry out administrative functions including the levying and collection of owners' association fees. Association may have the ability to levy liens or implement foreclosure actions for unpaid fees.

**Cooperatives** operate very differently. A corporation holds title to the property. Individuals who wish to occupy property owned by the cooperative purchase stock in the corporation and receive a proprietary, long-term lease to their unit, which usually cannot be assigned or sublet. An individual shareholder agrees to pay a proportionate share of expenses incurred by the corporation for maintenance, property taxes and debt service (the mortgage). Licensees cannot broker cooperatives unless they hold a **securities license**.

A **time-share** allows multiple owners the ownership or use of a single piece of property for a specified, determined amount of time. They are very typical in resort or vacation locations, each owner is responsible for his or her share of the property's expenses.

---

## Encumbrances

---

An **encumbrance** is an interest another entity has in one's real property that does not include a possessory right. Liens and easements are the most common encumbrances.

### *Liens*

When someone has full legal ownership of real property, we say they have **legal title**. As discussed earlier, legal title or ownership includes a bundle of rights, one of which is the right to encumber or place financing liens on the property. A **lien** is a charge or a claim against a person's property made to enforce the payment of money. A lien also represents an interest in ownership, but it does not usually constitute actual ownership of the property.

States manage liens two different ways, either lien theory or title theory. In a **lien theory state**, the lender who puts a mortgage lien on a property,

where the property is held as collateral if the borrower decides not to pay, holds **equitable title** while the homeowner has legal title. Equitable title refers to a non-ownership stake in the property that includes the right to purchase the property if certain contractual conditions happen. **Title theory states** give the lender legal title to the mortgage property until the **mortgagor** (borrower) satisfies the terms and obligations of the loan.

If a lien is not paid in the allotted time, the lienholder may **foreclose** on the lien, potentially forcing the sale of the property as set by state law.

#### TYPES OF LIENS

Voluntary	Created Intentionally
Involuntary	Not created by the owners choosing, but usually by legal action.
Statutory	Created by state statute or state law.
Equitable	Liens that arise out of common law. Usually, court ordered.
General	A lien placed against any and all assets (both real and personal).
Specific	A lien placed against one piece of property (either real or personal property).

Liens can be described in various ways, and often in combination. First, a lien is either **voluntary** or created intentionally by the owner, or **involuntary**, where the lien is created not because the owner chooses to but by legal action. For example, a homeowner voluntarily exercises his or her right to encumber a property and gets a loan that places the real property as collateral. Conversely, every year property taxes are due, a legal process creates a tax lien on that property whether the homeowner wants it or not.

Liens are also said to be either statutory or equitable. **Statutory** means created by state statute or state law. Real property tax liens are considered not only involuntary but also statutory, as state law allows the tax lien to be assessed. **Equitable** liens are those that arise out of common law. An example would be a court-ordered lien against owned property to ensure payment to the winning party of a lawsuit.

In the above example, a judge could decree a **general** lien be placed against any and all assets (real and personal property) owned by the losing party in a court case. If the losing party sold his or her house, boat, car, jet skis, etc., the proceeds from the sale would be sent to the winning party. A **specific** lien is placed against either one parcel of real property (123 Main Street) or personal property (Dodge Challenger, VIN#xxxxxxx), but not both.

As the holder of a lien, you would be concerned with how likely you are to be paid when the asset is sold or foreclosed. The order in which liens are paid, or **lien priority**, is decided based on whether the lien is superior or junior. **Superior liens** are paid first. Real estate tax liens, special assessment tax liens, federal estate tax liens and state inheritance tax liens are all superior liens that have priority. **Junior liens** are **subordinate** to superior liens and are paid based on the **date of recording** not the dollar amount owed, where the oldest liens are paid before more recent ones. Examples of junior liens include federal income tax liens, court-ordered judgment liens, mortgage liens, and mechanics' liens.

Superior Liens (In Rank Order)
1. Real Estate Tax Liens
2. Special Assessment Liens
3. Federal Estate Tax Liens
4. State Inheritance Tax Liens

Junior Liens (Priority is Set by Date of Recording)
Federal Income Tax Liens
State Corporate Income Tax Liens
State Intangible Tax Liens
Judgement Liens
Mortgage Liens
Vendor's Liens
Mechanic's Liens (priority is set by date work was performed.)

A **mechanic's lien** is placed on a property by a company that provided a good or service to a homeowner who didn't pay. Imagine a homeowner hires a contractor to build a deck. The contract is signed January 1<sup>st</sup> and the homeowner pays for half of the job up front. Lumber is dropped off at the property on January 4<sup>th</sup>. The construction crew arrives at 8:00 am on January 5<sup>th</sup> and completes work on January 10<sup>th</sup>. An invoice is sent to the homeowner for the remaining balance on January 11<sup>th</sup>. Per the contract, after 60 days of non-payment, the contractor files a lien against the property so they will be paid if and when the house is sold. While the lien is recorded on March 11<sup>th</sup>, the priority is established as of either the date the work was started (January 5<sup>th</sup>) or materials were first furnished (January 4<sup>th</sup>), or the date work was completed (January 10<sup>th</sup>) depending on state law.

The following example illustrates how lien priority is applied when paying off debt. In this example, a home is foreclosed on for non-payment of a mortgage lien that was recorded in 2010 for \$225,000 with a balance remaining of \$160,000. A second mortgage was recorded in 2015 with a balance due of \$25,000 and a mechanic's lien for \$11,000 was recorded in 2016. An unpaid real estate tax lien was recorded this year for \$2,450. The house sells for \$350,000. The liens would be paid as follows:

1. Tax lien - \$2,450
2. 1<sup>st</sup> mortgage - \$160,000
3. 2<sup>nd</sup> mortgage - \$25,000
4. Mechanics lien – \$11,000

The balance due to the homeowner is \$151,550.

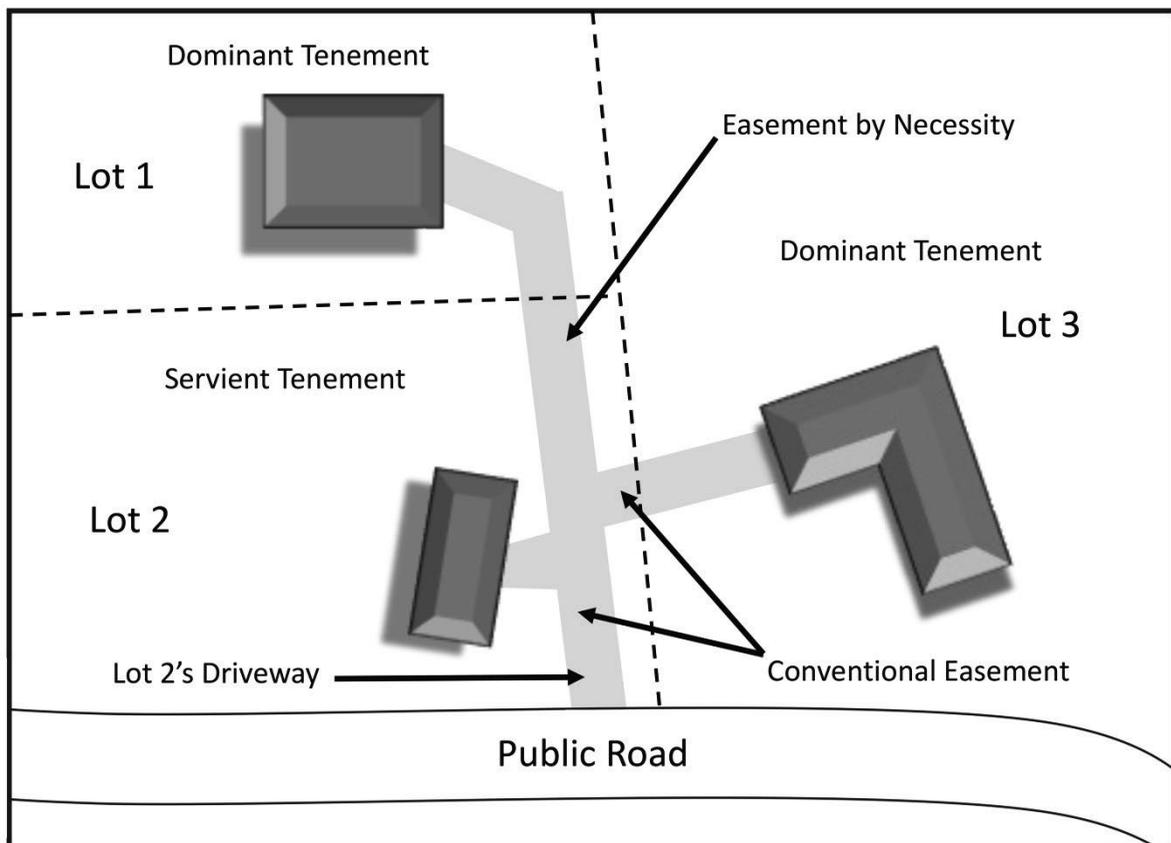
## ***Easements and Encroachments***

Legally, there are a number of ways owners can provide a right to use their land to another person for a particular purpose. **Easements** are written agreements between the parties that should be recorded and part of public record.

An **easement appurtenant** attaches to the ownership of land and allows one party to use an adjoining parcel owned by another. There are two

parties here: the **dominant tenement** has the right to use the other person's land while the **servient tenement** provides the easement to the dominant tenement. In effect, the servient tenement *serves* the dominant tenement by allowing the dominant tenement the right to cross his land. If the dominant tenement sells his land, the easement appurtenant (think "runs with the land") transfers with the title, allowing the new owner to retain his easement right.

### EASEMENT APPURTENANT



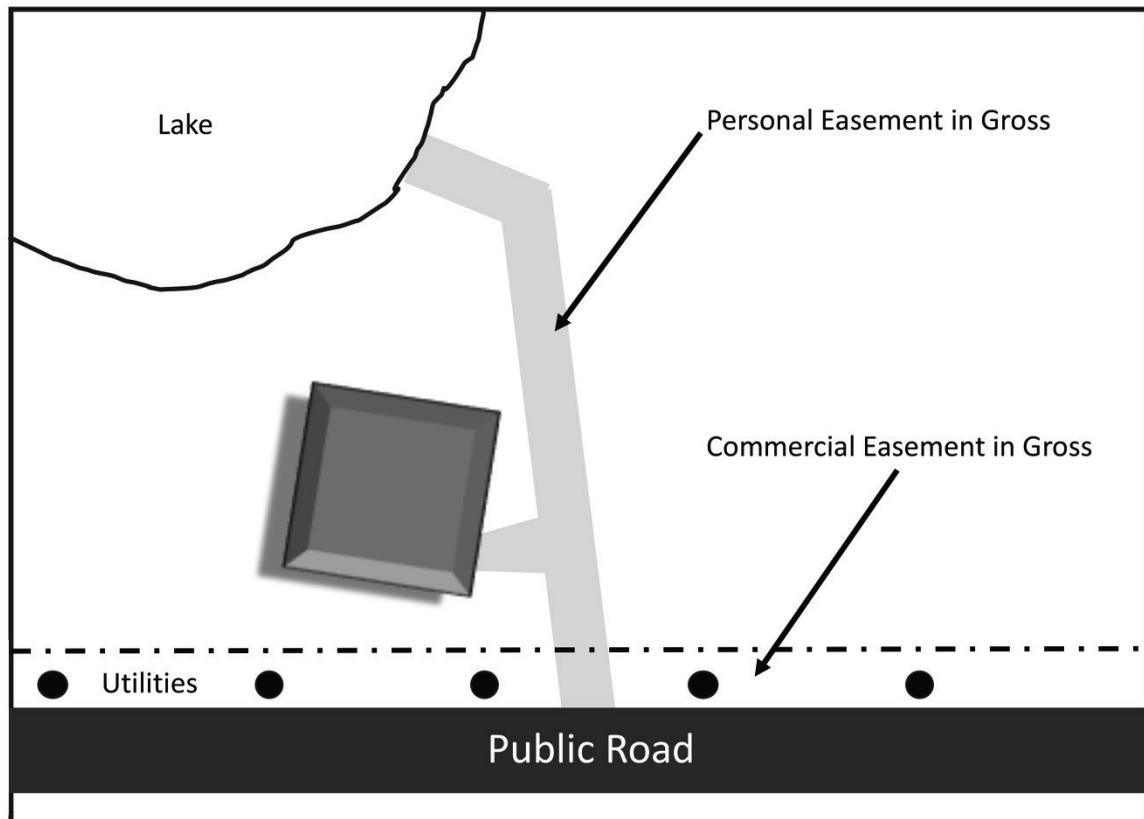
Another example of an easement appurtenant is a **party wall**. In the case of a condominium, different unit owners share a partition wall, each owning half of it. They also agree not to damage or destroy the wall they both share.

In some situations, easements may be granted – by necessity – to landlocked owners. Created by court order, an **easement by necessity** provides access to a street or public road as all landowners are guaranteed

the right of egress (exit) and ingress (enter) to their property. An easement by necessity is usually needed when a property owner subdivides his land into parcels in a way that leaves a parcel without road access.

When a utility company or a railroad has the right to use someone else's land we call this an **easement in gross**. This use does not attach to the estate, and it only affects one parcel of land. **Commercial** easements in gross are transferrable if the utility company is purchased and do not terminate on passing of the grantor or grantee. A **personal** easement in gross is not transferrable and ends upon the death of the easement holder (Grantee).

### EASEMENT IN GROSS

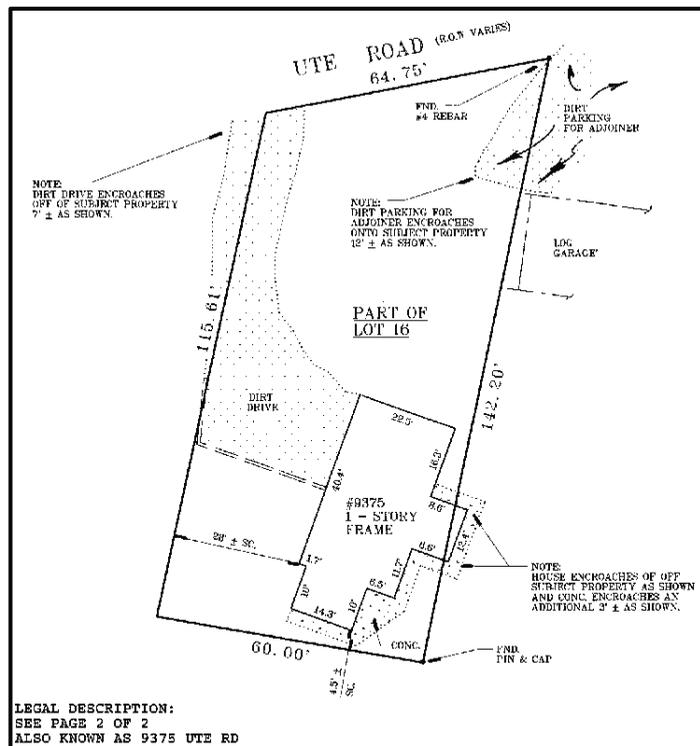


In some situations, if use of someone else's property without an easement meets certain criteria, the user of someone else's land can legally obtain the continued use via an **easement by prescription**. Let's say that your family has been crossing over your neighbor's land to get to a swimming

hole for years. Your parents took you along this worn path when you were young, and their parents took them. You and your family crossed the neighbor's land in the middle of the day without written permission. One day, the neighbor sold his land and the new owner posted No Trespassing signs on the path. You decide to go to court and show you had used that part of the neighbor's land through continuous (for years), open (in the middle of the day), and adverse (without permission) use over a period of time as determined by state law. The judge may grant you an easement by prescription that allows you to continue to use the neighbors land legally.

Another option to provide a right to use someone else's land is a **license**. This is a revokable, non-transferrable personal right to use a property. Licenses are used to legally allow someone to park an RV on someone else's land or erect a sign.

A parcel of land is clearly defined, not only by its legal description but by its lot lines. When a neighboring parcel allows a building, fence, driveway or even a tree to cross over the boundary line illegally, this is called an **encroachment**. Encroachments are usually identified by a **survey** or **Improvement Location Certificate**, both of which are created by a surveyor.



Encroachments that have existed a long time may qualify for an **easement by prescription**. If an encroachment was uncovered during the purchase process, the buyer's lender would probably require it to be corrected as a matter of obtaining financing. Easements by Prescription require to claimant to prove that there is legitimacy to their Adverse Possession claim.

## *Alienation*

**Alienation** is defined as an owner separating from real estate, and can be either **voluntary**, where the owner chooses to sell the property, give it to someone or will it to someone when they die, or **involuntary**, meaning against their wishes. Examples of involuntary alienation include eminent domain, adverse possession and foreclosure. Eminent domain and foreclosure are covered in future chapters.

If property owners abandon their property and stop paying real estate taxes, they open themselves up to the possibility that someone else could apply for ownership. For example, you have been gifted 20 acres of land in another state by your grandfather. You have no desire to do anything with the property and are now forced to pay property taxes on it. After a few years, you stop paying. You never visit it. But unbeknownst to you, someone else has decided to make it her home. That person parks a camper on the site and starts living there. She starts receiving mail there, introduces herself to the neighbors and acts like she owns the land. She's not hiding her residency and actually starts paying the property taxes. After a certain amount of time (as defined by each state) she can go to court and sue for **adverse possession** or legal ownership of the property. She will have to prove **Open** and **Notorious** (in the open and obvious), **Continuous** (regular possession), **hostile** (infringes on the rights of the true owner), **Exclusive** (does not share control and excludes others) and **Adverse** (is actually possessing the property without permission) use over time. The abbreviation **O.C.E.A.N.** can help to remember the requirements to prove Adverse Possession.

# Chapter 5 Key Point Review

---

1. Real Estate versus Real Property
  - a. Real Estate – Land plus man made improvements.
  - b. Real Property – land, improvements, attachments, and legal rights.
  - c. Bundle of Legal Rights
    - i. Right of Possession – the right to occupy.
    - ii. Right to Control or use – doing with the property those activities allowed by law.
    - iii. Right to Transfer – the right to sell, will, or transfer the property.
    - iv. Right to Exclude – the right to keep others from entering or using the property.
    - v. Right to Encumber – The right to place liens or provide non-possessory interest in the property to someone else.
2. Deeds
  - a. Ownership in real property is evidenced by a Conveyance Deed which documents:
    - i. Owners of the property
    - ii. Type of ownership
    - iii. The legal description of the property
    - iv. Potentially other items pertinent to the transfer of title.
  - b. An owner must use some form of written deed to transfer title to another owner.
    - i. Grantor (seller) – Owner conveying title.
    - ii. Grantee (buyer) – Buyer receiving title.
    - iii. Title passes from the grantor when the signed (only by the Grantor) deed is delivered to and accepted by the Grantee.
  - c. Several types of deeds that convey title and different warranties (promises) made by the grantor.
    - i. General Warranty Deed – Grantor provides the greatest protection for the Grantee.
      1. Covenant of Seisin – the grantor owns the property and has the right to convey it.
      2. Covenant Against Encumbrances – the grantor warrants that the property is free from any liens or encumbrances except those specifically stated in the deed.

3. Covenant of Quiet Enjoyment – the grantor guarantees that the grantee won't be disturbed by a third-party claiming ownership.
  4. Covenant of Further Assurance – the grantor promises to obtain and deliver any instrument required to make the title good against third party claims in the future.
  5. Covenant of Warranty Forever – the grantor promises to obtain and deliver any instrument required to make the title good against third-party claims even if those claims originated during a time when the grantor didn't own the property.
- ii. Special Warranty Deed – Grantor warrants that the property was not encumbered during the time that the grantor held title.
    1. Covenant of Warranty Forever is removed.
  - iii. Bargain and Sale Deed – the Grantor warrants that the title is valid.
    1. The Grantor may or may not warrant against encumbrances.
    2. The Grantor does not promise to defend against claims by other parties.
  - iv. Quitclaim Deed – contains no warranties or promises.
    1. Used to cure a defect in title (cloud on title.)
- d. A deed must contain the following essential elements to be valid:
- i. Grantor and Grantee
  - ii. Consideration
  - iii. Granting Clause
  - iv. Description of Real Estate
  - v. Signature of Grantor
  - vi. Delivery and Acceptance
- e. Acknowledgement (notarization) provides evidence that the grantor's signature is valid. Some states require Acknowledgement for the Deed to be considered valid.
- f. Title is transferred when the executed Deed is delivered and accepted by the Grantee.
- g. A Deed does not need to be recorded to be Valid.

### 3. Ownership Rights

- a. Ownership of any combination of the Bundle of Rights has an interest in the property.
  - i. Possessory interest – right to possess. (Lease, ownership, etc.)
    1. Referred to as an Estate in Land.
  - ii. Non-Possessory interest – no right to possess. (Lien, etc.)

- b. Freehold Estate – ownership for an indeterminable length of time.
  - i. Fee Simple – includes all the Bundle of Rights.
    - 1. Absolute – highest interest in real estate recognized by law.
      - a. Entitled to all the rights of the property.
      - b. Legal rights can pass to heirs through a will or laws of descent.
    - 2. Defeasible – owner’s interest is subject to the occurrence or non-occurrence of an event.
      - a. Determinable – rights automatically revert to the grantor or grantor’s heirs upon an event occurring.
        - i. Grantor does not need to physically take possession of the property.
      - b. Condition Subsequent – the owner might have the right to reclaim the property if a non-allowed event occurred.
        - i. Requires a court action.
        - ii. Grantor would have to physically re-possess the property.
  - ii. Life Estate
    - 1. Conventional Life Estate – ownership that is not inheritable.
      - a. Life Tenant owns the property for the duration of the measuring life.
      - b. Remainderman – person to whom the property will pass when the life estate ends.
      - c. Reversionary Interest – ownership returns to the original owner or heirs at the end of the life estate.
      - d. Pur Autre Vie (for the life of another) – a life estate based on the lifetime of a person other than the Life Tenant.
    - 2. Legal Life Estate – designed to protect family survivors.
      - a. Dower – the right a widow has in property owned by her husband.
      - b. Curtesy – the right a widower has in property owned by his wife.
      - c. Elective Share – allows a surviving spouse to make a claim upon their deceased spouse’s real and personal property, even if not named in the will.
      - d. Homestead – protect the “family home” from general creditors attempting to collect on debts.

- i. Usually requires both spouses to sign a Deed of Conveyance, even if only one spouse is named on the Deed.

#### 4. Types of Ownership

##### a. Individual Ownership

###### i. Tenancy in Severalty (Estate in Severalty)

- 1. Owned by a single person or a single entity.

###### ii. Trust

- 1. Transferring ownership of property to another to hold and/or manage for the benefit of a third party.

- a. Trustor – creates the Trust.

- b. Trustee – manages the Trust on behalf of the

- c. Beneficiary – those that benefit from the Trust.

- 2. Living Trust – created during the lifetime of the Trustor.

- 3. Testamentary Trust – created by will upon the death of a Trustor.

###### iii. General Partnership

- 1. Two or more people carry on a business venture as co-owners.

- a. General partners are entitled to participate in the management of the business.

- b. General Partnership dissolves if a General Partner dies, withdraws or the partnership goes bankrupt.

###### iv. Limited Partnership

- 1. Two types of partners:

- a. General Partners – responsible for the partnership's operation.

- b. Limited Partners – responsible for expenses and debts.
    - i. Have no voice in the partnership.

- c. Partnership agreement may provide for continuation of the partnership after the death or withdrawal of one of the partners.

###### v. Corporations

- 1. Considered an artificial person.

- 2. Made up of people who own stock in the company.

- 3. Run by a board of directors.

- 4. A corporation exists until it is formally dissolved.

###### vi. Limited Liability Company (LLC)

- 1. Combines attributes of both corporations and partnerships.

2. Tax advantages of a partnership.
  3. Limited liability like a corporation.
- b. Concurrent Ownership – when more than one person concurrently owns a property.
- i. Tenants in Common
    1. Undivided interests.
    2. Unequal ownership shares possible.
    3. No right of survivorship. Ownership passes by will or laws of decent.
    4. Interests can be conveyed to an outside party without permission of other Tenants in Common.
  - ii. Joint Tenancy
    1. Equal undivided interests.
    2. Equal ownership shares.
    3. Right of survivorship
    4. Four unities required:
      - a. Possession – equal possessory rights.
      - b. Interest – equal ownership share.
      - c. Title – created on the same document (Deed.)
      - d. Time – created at the same time.
    5. Can sell interests to a non-co-owner as a Tenant in Common interest.
  - iii. Tenancy by the Entireties
    1. Same conditions as Joint Tenancy but includes marriage.
    2. Spouses cannot act alone to sell the property.
  - iv. Community Property
    1. Separate Property – real and personal property acquired before a marriage or by gift or inheritance.
    2. Community Property – all other property earned or acquired during the marriage.
    3. Upon death of one spouse, the surviving spouse automatically owns one-half of the community property. The deceased spouse's share is passed on to their heirs.
    4. No automatic right of survivorship.
5. Common Interest Ownership Properties
- a. Condominiums – residential, commercial, or industrial units which allow for multiple owners in a larger building.

- i. Owner owns a fees simple title to air rights in a specific unit and an undivided interest in common areas as a Tenant in Common.
    - ii. Default by owner on their loan does not affect the other owners.
    - iii. Condominium developer must file a Declaration with the county for the condominium project.
      - 1. Includes by-laws and restrictive covenants, survey and architectural drawings.
    - iv. HOA (Homeowners Association) carry out administrative functions.
      - 1. Collect owners' fees.
      - 2. Can levy fines or implement foreclosure for non-payment of fees.
  - b. Cooperatives – corporation holds title to the property.
    - i. Individuals purchase stock in the corporation.
    - ii. Receive a proprietary long-term lease to a particular unit.
    - iii. Shareholder agrees to pay a proportionate share of expenses for maintenance, taxes, insurance, debt service, etc.
    - iv. Licensees must have a Securities License to broker cooperatives.
  - c. Time-Share – multiple owners the use of a single piece of property.
    - i. For a specified period of time.
    - ii. Typical in resort or vacation locations.
    - iii. Each owner responsible for their share of property expenses.
- 6. Encumbrances – an interest another entity has in a property that does not contain a possessory right.
  - a. Liens
    - i. Legal Title – full ownership of a property.
    - ii. Equitable Title – a right to obtain full ownership.
    - iii. Lien Theory State – lender places a lien on the property.
    - iv. Title Theory State – Lender has legal title under the borrower satisfies the terms of the loan.
    - v. Liens can be described as:
      - 1. Voluntary – created intentionally by the owner.
      - 2. Involuntary – created by legal action.
      - 3. Statutory – created by state statute.
      - 4. Equitable – liens that arise out of common law.
      - 5. General – can be placed against any and all assets.
      - 6. Specific – placed against only one piece of property.
    - vi. Lien priority – order with which liens are paid off when the asset is sold or foreclosed upon.

1. Superior liens – paid first. (Real estate tax liens, special assessment tax liens, federal estate tax license, state inheritance tax liens.)
  2. Junior Liens – paid based on the date of recording of the lien. (Federal income tax liens, court-ordered judgments, mortgage liens, mechanic’s liens.)
    - a. Mechanics Liens – Priority established as of either the date the work was started or when materials were first furnished.
- b. Easements – providing a right to use land for a particular purpose.
- i. Written agreements that should be recorded.
  - ii. Easement Appurtenant – allows use of an adjoining parcel owned by another.
    1. Dominant Tenement – has the right to use the others person’s land.
    2. Servient Tenement – provides the easement to the dominant tenement.
    3. Easement runs with the land and transfers with title if the property sells.
    4. Party Wall – (condominiums, shared walls, etc.) – parties share ½ of a common wall and agree to not damage or destroy the wall they both share.
  - iii. Easement by Necessity – granted by the court to landlocked owners.
  - iv. Easement in Gross – only affects one parcel of land.
    1. Commercial – transferrable and do not terminate on the passing of the grantor or grantee.
    2. Personal – not transferable and ends upon the death of the easement holder (grantee).
  - v. Easement by Prescription – the user of someone else’s land legally obtains an easement right. Requires:
    1. Continuous use.
    2. Open use
    3. Adverse use
  - vi. License – a revokable, non-transferrable right to use a property.
- c. Encroachments – when a neighboring parcel allows a building, fence, driveway, tree, etc. to cross over the boundary line illegally.
- i. Long term encroachments may qualify for an Easement by Prescription.
  - ii. Can be corrected by drafting an easement.



## Chapter 5 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. An acknowledged document is a document that was signed and witnessed by a notary.
2. The parties involved with a conveyance deed are the grantor and the grantee.
3. A conveyance deed voluntarily transfers title from the grantor to the grantee.
4. A recorded deed gives constructive notice to the public.
5. There are five essential elements for a valid deed.
6. Recording is one of the essential elements of a valid deed.
7. A competent grantee is one of the essential elements of a valid deed.
8. A competent grantor must be 18, sane and sober.
9. Listing the legal description on the deed meets the essential element of lawful objective to make the deed valid.
10. A granting clause is one of the essential elements needed for a valid deed.
11. The signature of the grantee is one of the essential elements of a valid deed.
12. Conveyance happens when the final essential element of a valid deed, deliver and acceptance, is exercised.
13. The habendum clause identifies the type of freehold estate that is being granted.
14. A general warranty deed conveys seven covenants (promises) from the grantor to the grantee.
15. The covenant of seizin allows the grantor reversionary interest in case of foreclosure.
16. The covenant of quiet enjoyment guarantees the grantee to have quiet neighbors.
17. The covenant against encumbrances is a promise that the grantor will convey the property free from any liens or encumbrances except those stated in the deed.

18. The covenant of further assurance is a promise from the grantor to obtain and deliver any instrument required to make the title good against third parties.
19. The covenant of warranty forever is when the grantor's promise that if the title fails, the grantee will be compensated for the loss sustained.
20. A general warranty deed is best for the grantee.
21. A quitclaim deed is best for the grantee.
22. A quitclaim deed is known as a problem solver and can be used to clear a cloud on title.
23. Real property is transferred using a bill of sale.
24. Personal property is transferred using a bill of sale.
25. A deed must be acknowledged/notarized for it to be considered valid.
26. A deed must be recorded for it to be considered valid.
27. Recording the deed benefits the grantor.
28. Recording a title document proves it is legal.
29. A dower is the surviving rights of a widow in real property of a deceased husband.
30. A curtesy is the widow's right in a deceased spouse's real property.
31. Joint tenancy allows for unequal interests in real estate.
32. A life estate is inheritable upon the death of a life tenant.
33. Tenants in common have the right of survivorship.
34. A life estate must have a Pur Autre Vie.
35. A life estate is a freehold estate.
36. A lien is a possessory interest in real estate.
37. In a general partnership, the partners share in the liability of the partnership and are entitled to their share of the profits.

38. In a limited partnership, the limited partner is only liable for the amount that was invested in the limited partnership.
39. A corporation is considered to be multiple persons when taking title to real property.
40. Timeshare owners have unlimited use of their property.
41. Timeshares are typically found in resort locations.
42. Real Property taxes are a junior lien.
43. Special assessments are a superior involuntary lien.
44. A mortgage is a voluntary general lien.
45. Joint tenancy has the right of survivorship.
46. Tenants in common may have unequal ownership shares.
47. Condominium owners own common elements as Tenants in Common with the other owners.
48. With a cooperative, one would receive stock in the corporation and a conveyance deed.
49. Upon the death of a life tenant, the life estate may revert to fee simple absolute to the reverter.
50. When a life estate passes to a third party, that interested party is considered the Remainderman.
51. In a cooperative, the real property is owned by the unit owners.
52. When a joint tenant dies, their interest passes to their heirs or devisees.
53. Community property is all assets purchased or acquired by a couple during their marriage owned equally by both of them.
54. Mechanic's liens are superior liens.
55. The priority for a mechanic's lien is established as of either the date the work was started or materials were first furnished, or the date work was complete, depending on state law.
56. Junior liens are paid after superior liens, and then based on the amount owed.

57. Easements are written agreements that allow the use of someone's land.
58. An easement by necessity helps a property from becoming landlocked.
59. An appurtenant easement is a type of easement that attaches to and runs with the land.
60. An easement in gross has a dominant tenement and a servient tenement.
61. Tenancy by the entirety is a type of multiple ownership for only married couples.
62. A prescriptive easement is obtained through the courts after open, continuous, exclusive, adverse and notorious use has been proved over a period of time.
63. A license is a type of irrevocable use of real property.
64. An encroachment would probably be found on title at the county recorder's office.
65. A tree limb hanging over a neighbor's property line is an example of an encroachment.
66. Legal title may be acquired by a prescriptive easement.
67. An easement appurtenant terminates upon the sale of a servient tenement property.
68. To run underground utility lines across an owner's property, the utility company must have an easement in gross.
69. A roofer has the right to file a mechanic's lien for an unpaid roof replacement invoice and date the lien back to when the supplies were delivered, rather than the date of recording.
70. A fee simple absolute has the most bundle of rights and has an indefinite duration.
71. A fee simple defeasible has the most bundle of rights and has an indefinite duration.
72. A life tenant may sell their life estate.
73. Joint Tenancy is the type of concurrent ownership designated only for married couples.
74. Sole ownership is a property type of ownership for a corporation.
75. An individual would normally take title to a property as estate in severalty.
76. Tenancy in common is a type of non-freehold estate.

# 6

## Land Use Controls and Regulations

**Government Rights in Land**  
**Other Government Controls**  
**Private Controls**

---

### Government Rights in Land

---

Property owners have many legal rights concerning their land, however, it's of little surprise that the government also has certain rights in privately held lands as well. Use the acronym **PETE** to remember these governmental rights.

**P**

**Police Power** - an inherent power of a state to adopt laws and regulations to promote the public health, safety, and general welfare. Examples are zoning laws and building codes.

**E**

**Eminent Domain** – the government's right to take private property when it is decided that such action is in the best interests of the public. The process is called **condemnation**.

**T**

**Taxation** - most state and local governments impose a tax upon real estate.

**E**

**Escheat** - if the owner of real estate dies **intestate** (without a will) and there are NO legal heirs, then their property reverts to the state.

## *Police Power*

The purpose of **zoning laws** is to preserve property values and promote orderly growth. Municipalities often develop a **master plan**, which ensures that social and economic needs are balanced along with environmental and aesthetic concerns. The master plan provides guidelines for current and future growth and addresses re-development and new development. In most jurisdictions, the master plan is managed by the local Planning Commission.

Master plans usually include:

- A land use element
- A transportation element
- Housing elements
- Capital improvements (parks, schools, libraries)

**Land use** is usually divided into six categories: **residential, commercial, industrial, agricultural, public and planned unit development (PUD)**. **Buffer zones** can also be used to separate undesirable adjoining uses (i.e. a park separating a residential area from an industrial area).

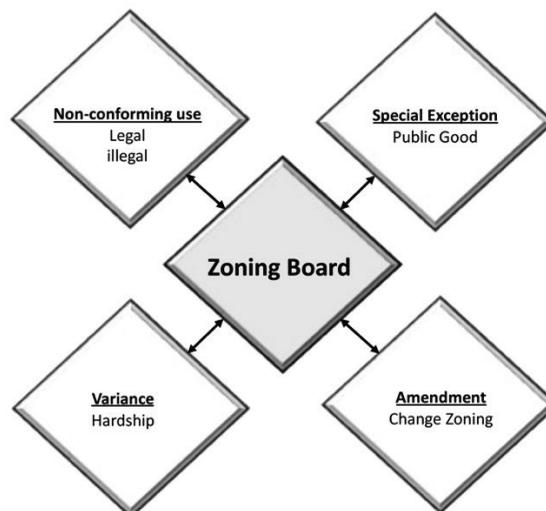
**Zoning ordinances** are local laws designed to implement the master plan by specifying land usage for every parcel in the jurisdiction, and to reasonably promote community health, safety and welfare.. These may address lot sizes, types of buildings, setbacks, or environmental concerns. **Exclusionary zoning** is designed to keep out certain uses for the land, while **inclusionary zoning** requires certain inclusions in a community, such as required affordable housing units in an area of upscale properties. Lastly, **aesthetic zoning** requires limitations on the architectural style of buildings, which may also regulate sign size and usage.

Most zoning ordinances have a provision that allows property owners to protest the zoning of their property. A **zoning board** would hear these protests and act like a court of appeals for those who want to use their land in ways not allowed by a zoning ordinance. Here are the most common zoning appeals:

1. **Non-Conforming Use** – a use that existed PRIOR to the current zoning but does not comply with the current zoning. An example of a **legal non-conforming use** would be an old neighborhood bakery that

was allowed at one time but recent zoning changes from commercial to residential put the bakery in violation. This legal non-conforming use is usually allowed to continue due to a **grandfather clause**. However, the owner may not be allowed to expand a non-conforming use, and if the building is destroyed or damaged, the owner may not be allowed to repair it and continue the non-conforming use. An **illegal non-conforming use** occurs when the usage of a property conflicts with zoning ordinances that were already in place.

2. **Variance** – where a property owner seeks an alteration to the current zoning regulations. He or she must show the uniqueness of the situation and that the variance will not diminish the value of surrounding property. Variances only deal with a single property; they do not change the zoning for an area. Let’s say the current zoning ordinance on a parcel of land requires a 15’ **setback** from the street (i.e. no building is allowed within 15’ of the roadway) but due to the lot’s odd shape, the only place to build a structure would require placement 10’ from the street. The owner could apply for a variance.
3. **Special exception (a.k.a. conditional use)** – granted by the zoning board when the desired use is not consistent with current zoning but is beneficial or even essential to the public, like a day care center in a residential area.
4. **Amendment** – used to fix the zoning. If a special exception is approved, an amendment would change the zoning for the above parcel from residential to commercial.



Another example of police power is the institution of **building codes**, which regulate building construction and material standards. Property owners wanting to make alterations or additions to a property must obtain a **building permit** from the county. Once the project is completed it must be inspected and a **Certificate of Occupancy** issued. Local building inspectors are primarily responsible for enforcing building codes.

## *Eminent Domain*

The government reserves the right to take private lands for public benefit. This power, called **eminent domain**, provides that payment must be made to the landowner based on the fair market value of the property taken. The power of eminent domain can be delegated to others, such as utility companies and public schools. The process is called **condemnation**.

Consider when a highway needs to be widened. The local government can use eminent domain to purchase properties they need for the expansion as long as the current property owners are justly compensated. Transferring title to the government removes existing leases, liens and other encumbrances currently on the property.

**Severance damage** can be awarded to the landowner if taking only part of a parcel lowers the remaining property value, or the landowner can seek **inverse condemnation**, asking the government to condemn and compensate him for the full parcel because the reduction in value from condemning only part of the property leaves the property owner with little to nothing of value.

## *Taxation*

While the federal government can tax the income property owners make when they sell real estate, there are no federal property taxes thanks to the United States Constitution. States, however, can impose property taxes, but most delegate this to local counties, cities or taxing districts.

Taxes are portioned among landowners. A certain amount of a local government's income must be derived from real property taxes, however, some properties are **exempt** from taxation, such as properties owned by federal, state and local governments; schools; churches; and hospitals. The total amount of tax dollars collected by the municipality is determined by dividing the total amount of revenue needed by the total assessed value of all taxable property (excluding exempt properties). Once the total assessed value of all taxable property is determined, then each property owner's share can be computed.

Let's say the city needs \$14,000,000 in property tax revenue and the assessed value of taxable property in the city is \$350,000,000. The tax rate would be calculated as  $\$14,000,000 \div \$350,000,000 = .04$ . This **tax rate** is talked about as a **millage rate** or **mill rate** because the standard is based on one tenth of one cent (\$.001).

**40 mills**  
**\$4 per \$100**  
**\$40 per \$1,000**  
**.04 (4 percent)**

The tax rate in this example could be expressed as .04 or 40 mills. When answering math questions, 40 mills would be four dollars of tax per hundred dollars of assessment (\$4/\$100) or forty dollars of tax per thousand dollars of assessment (\$40/\$1000).

In some cases when a property owner owns property and declares it at their permanent principal residence, the property owner may be eligible to receive a **homestead exemption** that would decrease the property's taxable value. Not all states offer this, but those that do can see a reduction of the property's taxable value by multiple thousands of dollars. The homestead exemption amount would be subtracted from the market value of the property prior to the calculation of the assessed value of the property by the tax assessor.

The county assessor determines the fair market value of a property by comparing it with sale prices of comparable properties, or by using other

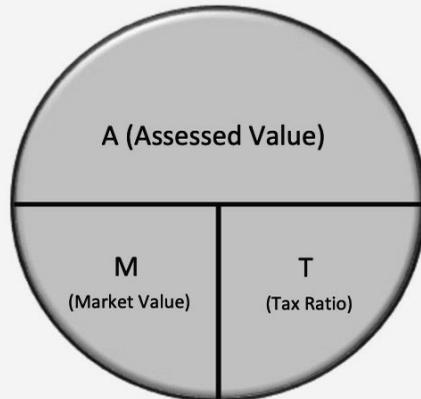
appraisal techniques. **Ad Valorem taxes** (According to Value) are based on the **assessed value**, which is a percentage of the market value. This percentage is called the **tax ratio** and it varies based on property type (land, residential, commercial, etc.). In some cases, an **equalization factor** will be utilized which adjusts assessments in a locality to make them more consistent with an average level for the state or other higher-level jurisdictions. The more valuable the parcel of land, the greater the tax that will be imposed upon it. Property owners can appeal the tax assessor's calculated assessed value for their property if they feel the calculation is unjust or incorrect. This **property tax appeals board** is often made up of county commissioners.

<b>Real Property Tax Bill Calculation</b>		
<b><u>Taxable Value</u></b>		
Market Value		\$425,000
- Homestead Deduction		\$50,000
Adjusted Market Value		\$375,000
Assessed Value (28% of Market Value)		<b><u>\$105,000</u></b>
Taxable Value		<b><u>\$105,000</u></b>
<b><u>Tax Calculations</u></b>		
Taxable Value		\$105,000
General Community Tax.	4 mills (.004)	\$420.00
School Tax	3 mills (.003)	\$315.00
Fire Protection District.	2 mills (.002)	\$210.00
Special Taxing District.	7 mills (.007)	\$735.00
<b><u>Total Tax</u></b>		
Total Real Property Tax Bill		<b><u>\$1,680.00</u></b>

## Math- Calculating Property Taxes

Calculating how much a property owner will pay in property taxes is often a two-part process. First, it is necessary to find the assessed value. The formula is:

$$\text{Market Value} \times \text{Tax Ratio (Rate)} = \text{Assessed Value}$$



Think of this as the AMT circle formula.

**A = Assessed Value**

**M = Market Value**

**T = Tax Ratio**

Next, determine the tax dollars owed. The formula is:

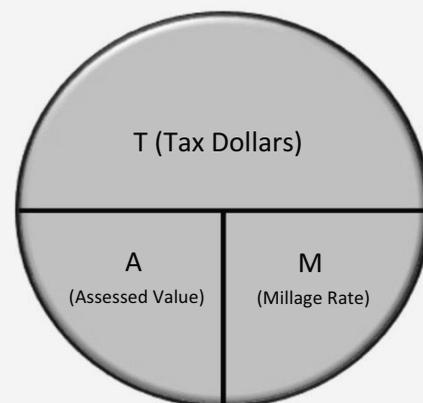
$$\text{Assessed Value} \times \text{Millage (Rate)} = \text{Tax Dollars}$$

This is called the TAM circle formula.

**T = Tax Dollars**

**A = Assessed Value**

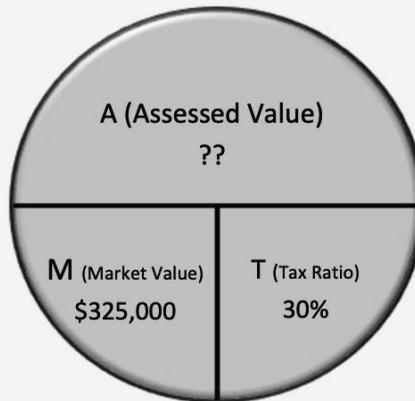
**M = Millage Rate**



**Question 1 – The market value of a property is \$325,000. If the tax ratio is 30% and the tax rate is 27 mills, what is the annual tax?**

**Step 1 – Calculate the assessed value. (Note that the question provides market value. Taxes are computed based on assessed value, not market value.)**

Draw the circle formula. (AMT)



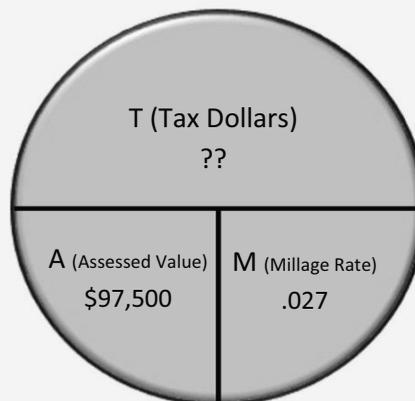
The formula visually instructs you to multiple the Market Value x Tax Ratio.

$$\$325,000 \times .30 = \$97,500 \text{ (Assessed Value).}$$

**Step 2 – Calculate the annual tax.**

**Remember, the conversion factor from mills to a decimal is .001. A mill is equal to 1/10 of a cent, so 27 mills x .001 = .027 or \$27 per \$1,000 of assessed value.**

Draw the Circle Formula



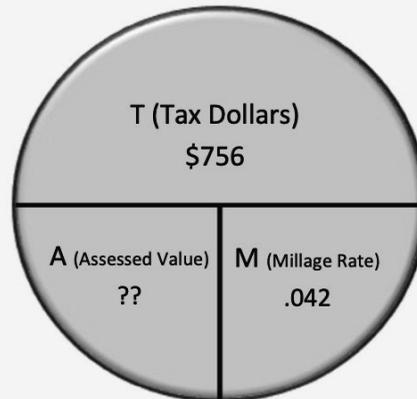
$$\$97,500 \times .027 = \$2,632.50 \text{ (Annual Real Estate Taxes)}$$

**Question 2 – The tax rate is 42 mills. If the quarterly tax is \$189, what is the assessed value of the property?**

**Step 1** – Convert quarterly tax dollars to annual tax dollars.

$$\$189 \times 4 \text{ (quarters in a year)} = \$756 \text{ annual tax dollars.}$$

**Step 2** – Draw the circle formula.

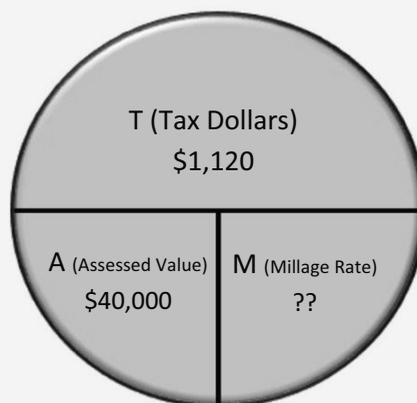


The formula visually instructs you to divide the Tax Dollars by the Millage Rate.

$$\$756 \div .042 = \$18,000 \text{ (Assessed Value).}$$

**Question 3 – What is the millage rate on a property with an annual tax bill of \$1,120 and an assessed value of \$40,000?**

Draw the Circle Formula.



The formula visually instructs you to divide the Tax Dollars by the Assessed Value.

$$\$1,120 \div 40,000 = .028 \text{ (28 mills).}$$

Tax is billed, due and automatically becomes a superior lien on the property, which means it has the highest lien priority. States determine when property taxes are due; the date may be based on a fiscal rather than a calendar year. If taxes are not paid when due, the property can be sold at public auction to pay the **delinquent taxes**. The winning bidder is often issued a **tax certificate** – not a deed – because the defaulting homeowner still has a period time within which to pay all taxes due and applicable fees. During this time, the tax certificate holder pays the property tax. At the end of this period, if the homeowner hasn't paid, the certificate holder can apply for a tax deed (or treasurer's deed).

Additionally, general ad valorem real property taxes are deductible by the property owner on his or her income tax return.

**Special assessments** are taxes levied against specific properties to pay for local improvements like street paving, curbs and gutters. These taxes are levied only against the property that will benefit from the improvement, and only to the extent that the property participates. If the homeowners in a neighborhood determine that there aren't enough streetlights to ensure the safety of those in the community, they could petition the city to install more. The city wouldn't increase the property taxes of all the people within the city limits but would levy a special assessment on just those homes that benefitted from the new streetlights.

The amount of the special assessment billed to each homeowner is often based on the amount of their lot that is adjacent to a street or road, called **front footage**. A lot's measurements are usually expressed in feet, where the first number presented is the front footage. For example, if a lot is 100' x 70', the front footage for any special assessment calculation would be based on 100'. If the lot is described as 70' x 100' then the assessment is calculated using 70'.

Special assessments are a lien against a property and have priority second only to general property taxes. They may have various payment arrangements, like monthly payment or a lump sum. A real estate sales contract will need to clearly indicate who is responsible for a special assessment. Lenders may require that they be paid off; if not, the special assessment could usurp the lender's lien position. Special assessments are not deductible on the owner's income tax.

## *Escheat*

When property owners die, hopefully they have identified what should happen to their real estate in a last will and testament or **will**. This legal document voluntarily transfers real and personal property. The deceased person is the **devisor** or giver of real property through a will. The **devisee** is the person named in the will to receive real property. An **heir** would be someone related to the deceased. A court action called probate commonly settles the deceased's estate, whether that person died with a will or without one.

To avoid a situation where real property is without an owner, the government retains the right to retake ownership of property if the owner dies **intestate** (without a will) and there are no legal heirs. Before that happens, the state will try to identify heirs using **laws of descent**, which stipulate who inherits and at what share. Abandoned property can also **escheat** to the government.

---

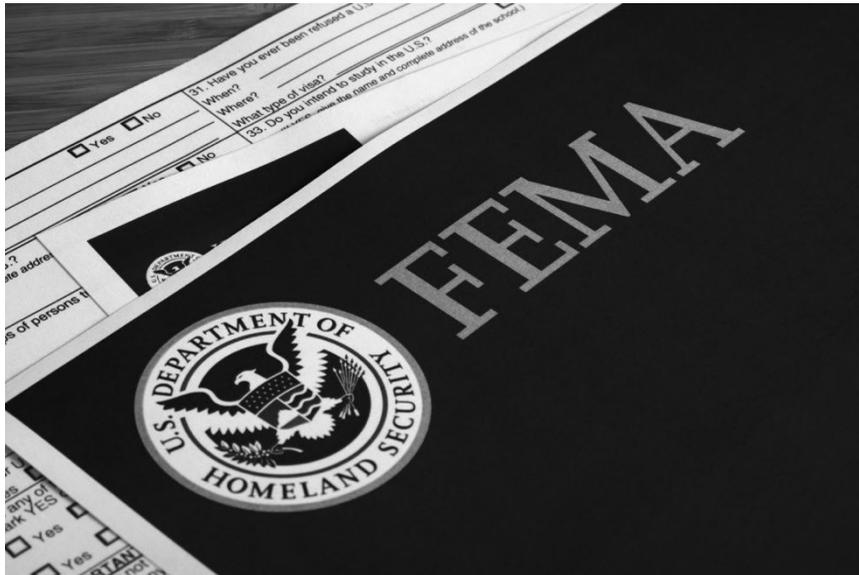
## **Other Government Controls**

---

The government controls land usage through other means. **Environmental impact reports** require that landowners identify and examine the likely effects of a project or how the proposed development will impact the surrounding area.

Regulations are often put into place on special land types. **Wetlands** are regulated at federal, state and local levels. Those regulations may cover seasonal standing water, shallow water tables, ponds or streams. In some cases, a designated and regulated wetlands area may appear dry, may not contain marsh plants and may even be forested. It still may be regulated and protected by the government.

The **Federal Emergency Management Agency** is an agency of the United States Department of Homeland Security. One of its roles is to define **flood plains**, or areas with a 1% or greater chance of flooding in any given year.



Zoning may require building a certain distance away from the flood plain boundary and may require that the building be elevated to a specified height. Lenders financing a property may require **flood insurance**. Flood zones (100- and 500-year flood plains) are detailed on the Army Corps of Engineers flood plain maps.

The Coastal Zone Management Act of 1972 allows the federal government to control and protect **coastal land use**. It preserves the habitat value of the beach; protects wetlands; and guarantees public access to the coast with setback lines, strict building codes and ensuring **beach nourishment** (the process of placing additional sediment on a beach or in the nearshore).

## ***Regulation of Environmental Hazards***

As discussed in Chapter - 3 Real Estate Laws & Ethics, licensees must be aware of and disclose information concerning their knowledge of certain **environmental hazards** such as lead-based paint, radon, pest infestations, asbestos, carbon monoxide, mold, and the presence of septic tanks. Not surprisingly, the government also is involved in regulating many of these environmental hazards due to the risks they pose to the public.

As an example, the Residential Lead-Based Paint Hazard Reduction Act of 1992 directs the Environmental Protection Agency to regulate lead-based paint hazards in paint, dust, soil, air and water. The **Residential Lead-Based Paint Disclosure Program** (Section 1018 of Title X of the Toxic

Substances Control Act) requires owners of residential properties built before 1978 (when the use of lead-based paint was banned) to disclose the presence of known lead-based paint hazards such as peeling or flaking paint or lead water pipes. Sellers must also present to buyers and tenants a federal lead hazard pamphlet. Buyers will have up to 10 days to have a lead risk assessment performed on the property if they choose to do so.

Additionally, the EPA has established safe radon level guidelines. If radon gas is present in a home at unacceptable levels, mitigation systems can be installed. Other environmental hazards of note include:

- **Asbestos** – a naturally occurring mineral that is resistant to heat and corrosion. Used as insulation in pipes, floor tiles, and building materials. Problems arise when asbestos particles become friable (airborne) and has been linked to lung cancer.
- **Urea-Formaldehyde Foam Insulation** - used to insulate buildings before 1978. Was banned because of toxic out-gassing.
- **PCB's (Polychlorinated Biphenyls)** - Used in the manufacture of electrical products prior to 1977. Many products containing them are still in operation.
- **Groundwater contamination** - Contamination of water that may be a source for wells.
- **Waste-disposal sites** (landfill operations) – concerns are leakage of waste material into the local water system. Usually heavily regulated by state and federal authorities.
- **Underground Storage Tanks** - used in residential and commercial settings, these tanks hold hazardous substances such as gasoline. Containers become old, rust, and leak toxic material that could enter the groundwater, contaminate wells, and pollute the soil.
- **Pesticides and herbicides** used in farming.
- **Electromagnetic fields (EMF's)** - generated by the movement of electrical currents. Usually caused by high-tension power lines, they are suspected to cause cancer and other health issues.
- **Mold** - an organism that may cause allergic reactions as well as asthma episodes, infections, and other respiratory problems. The EPA has established guidelines to remediate mold problems for schools and commercial buildings. Mold can have devastating effects on a property's condition and value if left untreated.

## *Abatement, Mitigation and Cleanup Requirements*

**CERCLA**, or the Comprehensive Environmental Response, Compensation, and Liability Act, was created in 1980. Through it, a \$9 billion dollar fund nicknamed “**Superfund**” was created to pay for the cleanup of uncontrolled hazardous waste sites and to respond to spills. CERCLA, which is enforced by the EPA, identifies responsible parties and orders them to take accountability.



Landowner liability under Superfund is classified as either strict, or joint and several. **Strict liability** means the owner is responsible to the injured party without excuse. **Joint and several liability**, however, says that each individual owner is personally responsible for the damages in whole; if only one owner is financially able to handle the total damage, that owner will have to pay all of it and attempt to collect the proportionate share from the other owners.

The Superfund Amendments and Reauthorization Act of 1986 established stronger cleanup standards for contaminated sites. Substantially increasing funding for the Superfund, it attempted to clarify lenders’ obligations, including creating a concept called innocent landowner immunity. In 2001-2002, the Brownfields Revitalization and Environmental Restoration Act further reduced the risk to innocent landowners who purchased once environmentally contaminated real estate.

The cost of cleaning up and removing pollution may be much greater than the dollar value of the property before the pollution occurred. Sometimes mortgage and title company approval may be contingent upon a hazardous substances inspection that verifies proof of their absence.

Most state laws do not require the real estate professional to discover these issues. The burden to disclose both known and latent (hidden) property defects to the buyer is shifted to the seller. If the broker knows or has been made aware of a material defect, he or she is then obligated to disclosure.

---

## Private Controls

---

While we have covered the numerous ways in which the government controls how property owners can use their land, several private controls can also be put in place that further restrict land usage. Developers may institute **deed restrictions**, commonly called **covenants, conditions and restrictions (CC&Rs)**, that might place setback requirements, improvement square footage minimums or maximums, exterior paint color specifications, or other extra requirements on a property owner.

Homeowners' Associations (**HOAs**) institute and enforce their own rules and regulations to protect residents' common interests. These rules generally relate to the property's use and operation. HOAs can charge fees, non-payment of which can result in foreclosable liens.

**Deed conditions** may also restrict certain property uses, much like deed restrictions. Violating a deed condition, however, gives the grantor the right to re-take possession of the property and file a suit for legal title.



# Chapter 6 Key Point Review

---

1. Governmental Rights in Land
  - a. P.E.T.E.
    - i. P – Police Power – the power of a state to adopt laws and regulations to promote public health, safety and welfare.
      1. Zoning laws.
      2. Building Codes.
    - ii. E – Eminent Domain – government’s right to take private property when it is decided that it is needed for the best interests of the public.
      1. Also called Condemnation.
    - iii. T – Taxation – imposed taxes upon real estate.
    - iv. E – Escheat – when a property owner dies without heirs (intestate) and there are no legal heirs, the property reverts to the state.
  - b. Police Power
    - i. Zoning Laws – used to preserve property values and promote growth.
    - ii. Master plan – provides guidelines for current and future growth.
      1. Land use – divided into six categories:
        - a. Residential
        - b. Commercial
        - c. Industrial
        - d. Agricultural
        - e. Public and Planned Unit Development (PUD)
        - f. Buffer zones – used to separate undesirable adjoining uses.
    - iii. Zoning Ordinances – specify land usage for every parcel in a jurisdiction.
    - iv. Zoning Board of Appeals – allows property owners to appeal for a use of their property not currently allowed by zoning ordinances.
      1. Non-Conforming Use
        - a. A use that existed prior to the current zoning but does not comply with current zoning (Legal Non-Conforming Use).
          - i. Allowed to continue due to a grandfather clause.
        - b. Illegal Non-Conforming Use – occurs when the use of a property conflicts with zoning ordinances that were already in place.
      2. Variance
        - a. Where a property owner seeks an alteration to the current zoning regulations.
      3. Special Exception (Conditional Use)
        - a. Granted when the desired use is not consistent with current zoning but is beneficial to the public.
      4. Amendment
        - a. Used to fix zoning.
    - v. Building Codes – regulate construction and material standards.
      1. Building permits from the county usually required for alterations or additions.

2. Certificate of Occupancy – issued once a project is completed and inspected.
- c. Eminent Domain (Condemnation)
- i. The government reserves the right to take private lands for public benefit.
    1. Payment must be made to the landowner based on the fair market value of the property taken.
    2. Eminent Domain removes existing leases, liens and other encumbrances currently on the property.
- d. Taxation
- i. There are no Federal Property Taxes.
    1. States impose property taxes.
      - a. Usually delegated to local counties, cities or taxing districts.
  - ii. Ad Valorem Taxes (According to Value)
  - iii. Proportioned among landowners in a region.
    1. Some properties are Exempt (governmental, schools, churches, hospitals, etc.)
  - iv. Tax Rate = Revenue Needed ÷ Assessed Values (minus Exempt properties)
    1. Known as Millage Rate
  - v. Millage Rate (Mill Rate)
    1. One tenth of one cent (.001)
      - a. .04
      - b. 40 mills
      - c. \$4/\$100
      - d. \$40/\$1000
  - vi. Assessed Value
    1. County assessor determines the fair value of a property.
    2. Assigns an assessed value.
      - a. Also known as the Tax Ratio
      - b. A percentage of market value.
  - vii. Calculating Taxes
    1. Market Value x Tax Ratio (Rate) = Assessed Value
    2. Assessed Value x Millage Rate = Tax Amount
  - viii. Taxes become a superior lien on the property.
    1. Has the highest lien priority of any lien.
    2. States determine when property taxes are due.
    3. If not paid, taxes may be sold at a public auction to pay the delinquent taxes.
      - a. Tax Certificate – issued to the winning bidder.
      - b. Property owner has a redemption period to pay off the property tax.
      - c. If unpaid the certificate holder may apply for a tax deed or treasurer’s deed and receive the property free and clear of any liens.
  - ix. Special Assessments

1. Pay for local improvements like street paving, curbs, gutters, etc.
  2. Levied only against the property that will benefit.
    - a. Amount billed usually based on Front Footage
      - i. The amount of the lot that is adjacent to the street or road.
  3. Senior lien, second in priority to General Real Estate Taxes.
- e. Escheat
- i. The government retains the right to retake ownership of property if the owner dies intestate (without a will) and there are no legal heirs.
  - ii. Abandoned property can also escheat to the government.
2. Other Government Controls
- a. Environmental Impact Reports – an examination of the effects of a projects impact on the surrounding area.
  - b. Wetlands – regulated at federal, state and local levels. Overseeing and protecting water, ponds, streams, etc.
  - c. Federal Emergency Management Agency (FEMA)
    - i. Flood plains – areas with a 1% or greater chance of flooding.
    - ii. Flood insurance - required by lenders if property is in a flood plain.
      1. 100- and 500-year flood plains
      2. Detailed on the Army Corps of Engineers flood plain maps.
  - d. Coastal Zone Management Act
    - i. Allows the federal government to control and protect coastal land use.
  - e. Residential Lead Based Paint Disclosure Program
    - i. Section 1018 of Title X, Toxic Substances Control Act
    - ii. Requires owners of residential properties built prior to 1978 to disclose the presence of known lead-based paint to Buyers or Tenants.
    - iii. Buyer or Tenant has a right to a 10-day review period.
  - f. Environmental Protection Agency
    - i. Urea-Formaldehyde Foam Insulation – used prior to 1978 for insulation.
    - ii. PCB's (Polychlorinated Biphenyls) – used prior to 1977 in the production of electrical products.
    - iii. Groundwater contamination – contamination of water that might be a source of well water.
      1. Waste-disposal sites (landfills)
      2. Underground Storage Tanks
      3. Pesticides and Herbicides
    - iv. Electromagnetic Fields (EMF's) – caused by high tension power lines.

- v. Mold – organism that may cause allergic reactions, infections and respiratory problems.
  - 1. Disclosure is not required by the federal government.
  - 2. EPA has established guidelines to remediate mold problems for schools and commercial buildings.
  
- g. CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act)
  - i. Created in 1980.
  - ii. Superfund was created to pay for the cleanup of uncontrolled hazardous waste sites.
  - iii. Enforced by the EPA.
  - iv. Identifies responsible parties for contamination and orders them to take accountability.
    - 1. Strict Liability – owner is responsible to the injured party.
    - 2. Joint and Several Liability – each individual owner is personally responsible for the damages as a whole.
  - v. Burden to disclose both known and latent (hidden) property defects to the buyer rests on the seller.
    - 1. Broker is not obligated to discover issues.
    - 2. If Broker is aware of an issue, they must disclose what they know.

### 3. Private Controls

#### a. Deed Restrictions

- i. Commonly called Covenants, Conditions and Restrictions (CC&Rs)
  - 1. Can place setback requirements, square footage minimum and maximums, paint color specifications, etc.
- ii. HOA's institute and enforce their own rules and regulations.
  - 1. Generally related to the property's use and operation.
  - 2. HOA's can charge fees.
    - a. Nonpayment of fees can lead to foreclosure.

#### b. Deed Conditions

- i. Restrict property uses.
- ii. Violating a deed condition gives the grantor the right to re-take possession of the property and file a suit for legal title.

# Chapter 6 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. Taxation, Escheat, Condemnation and Police Power are the governmental rights of land use control.
2. Zoning, building codes, building permits and certificates of occupancy are under police power.
3. If an owner dies intestate and has no heirs, the government power of Eminent Domain is exercised, and the property reverts back to the government.
4. Condemnation is the process by which the government exercises their right of Eminent Domain.
5. The zoning in a neighborhood changed, potentially affecting a local bakery. The local government can allow the bakery to continue its business, but it would be considered a legal non-conforming use.
6. A school in a residential neighborhood can exist under a variance.
7. Assessed value is the same as fair market value.
8. Police Power is the government power that promotes public health, safety and protection of the public.
9. A property tax is based on the market value of the property.
10. A setback is controlled through zoning ordinances.
11. The purpose of zoning laws is to preserve property values.
12. A certificate of occupancy must be obtained before beginning construction of a building.
13. A certificate of completion is needed prior to occupying a newly constructed building.
14. A variance allows a property owner to slightly vary from the current zoning regulations.
15. Government buildings, schools, churches and hospitals are exempt from paying property taxes.

16. Ad Valorem is determined by multiplying the mill levy/millage rate by the assessed value of the property.
17. The millage rate (MILL) is equal to one tenth of one cent (\$0.001).
18. Special assessments are levied against the front footage of a property for the purpose of local improvements like sidewalks or streetlights.
19. Eminent Domain allows the government to “take” private property for public use for just compensation.
20. A buffer zone is used to separate two different adjoining uses.
21. Zoning ordinances are used to regulate construction and material standards for buildings.
22. Environmental Impact Reports examine the likely environment effects of a project and must be disclosed to all potential buyers.
23. Flood plains are areas with a 1% chance of flooding in any given year and may require flood insurance if financing is involved.
24. A Master Plan promotes the orderly growth in an area and meets social and economic needs.
25. Lead based paint hazards must be disclosed if a property has a building permit issued prior to January 1, 1982.
26. Buyers have up to 20 days to have a lead-risk assessment performed on a property, if desired.
27. Police Power controls deed restrictions.
28. Lead hazards can be found in paint, water and soil.
29. Lead hazards must be disclosed for all types of real property.
30. Real estate professionals (not sellers) must provide buyers with the federal EPA Lead Hazard pamphlet.
31. Mold remediation is the removal of mold issues which left untreated might negatively affect a property’s condition and value.
32. Private land use controls are enforced by police power.

33. Deed restrictions are commonly known as covenants.
34. Superfund Amendments and Reauthorization Act of 1986 established stronger cleanup standards for contaminated sites.
35. High-tension power lines create asbestos, which is suspected of causing cancer and other health concerns.
36. The millage breakdown for ad valorem taxes are : library: .5 mills, school: 1 mill, school debt service: .5 mills, community college: 1 mill, vocational school: .5 mills, and all others: 5 mills. A property has an assessed value of \$165,000. The tax bill is \$1,405.75.
37. If the assessed value of a house is \$60,000 and its annual taxes are \$330, taxes on a similar house assessed at \$72,000 would be \$396.
38. Woodmen Road serves as a major thoroughfare from the town of Falcon to Colorado Springs, however it is woefully inadequate to handle the increased traffic from these growing towns. The city decides to spend \$2,500,000 to increase the road from two lanes to four and install two traffic lights. Current demographics show that 4,567 properties will benefit from the road expansion. Mrs. Bowen lives in Falcon. Her share of this special assessment is \$648.
39. Mrs. Bowen's property measures 111.3' x 190.7'. The Woodmen Road special assessment is .33 mills per front foot. She pays a special assessment of \$.04.



# 7

## Valuation and Market Analysis

### Real Estate Market Economics Appraisals

---

#### Real Estate Market Economics

---

Understanding the fundamentals of real estate economics helps real estate professionals recognize the effect that current economic conditions have on the real estate market in terms of transactions, housing prices, and property values. Armed with this knowledge, licensees can apply economic principles to estimate future conditions in the real estate market as well as specific geographical areas and property types; this information will help licensees determine the impact on a particular property and site.

The goal of an economic system is to produce and distribute a supply of goods and services to satisfy the demand of its constituents. Economic activity therefore centers on the production, distribution and sale of goods and services to meet consumer demand. Thus, we say that **supply** is the quantity of a product or service available for sale, lease, or trade at any given time and **demand** is the quantity of a product or service that is desired for purchase, lease, or trade at any given time. In the context of residential real estate, supply is the number of properties available to purchase and demand is the number of homes buyers want to purchase.

We also need to talk about the difference between price and value. **Price** is the amount of money or other assets that a buyer has agreed to pay and a

seller has agreed to accept to complete the exchange of a good or service. Price, therefore, is objective. On the other hand, **value** is based on the answers to four questions:

1. How much do I desire it?
2. How useful is it?
3. How scarce is it?
4. Am I able to pay for it?

As you can tell from the words used, value is subjective and can vary from buyer to buyer. Consider a four-bedroom, four-bathroom 3,600 square-foot home. A family of five may find this house very valuable, where an older couple with grown children may not. We call these concerns the **components of value**: Desire/demand, Utility, Scarcity, and Purchasing Power. Another component to consider is **transferability**, or the value assigned to the property's ability to be sold (remember the acronym DUST/P). For example, if there are clouds on the property's title that keep it from being transferred to another owner, its value is reduced considerably.

Since consumers will pay the lowest possible price for comparable goods and services, the producer must be price-competitive to stay in business. A competitor who can produce an item of similar quality for less will eventually force higher-priced items out of the market. If two identical apples are available to buy, demand will be highest for the least expensive apple. Supply, demand, and price interact continuously in a market. Underlying and influencing these forces are the dynamics of value and the costs of producing goods and services.

## ***Real Estate Supply and Demand***

A **market** is a place where supply and demand encounter one another: suppliers sell or trade their goods and services to demanders, who are consumers and buyers.

If Supply increases relative to Demand – price goes



If Supply decreases relative to Demand – price goes



If Demand increases relative to Supply – price goes



If Demand decreases relative to Supply – price goes



Understanding the above points is important but also intuitive. If the number of homebuyers stays constant, but more homes come on the market than before, the prices on those home go down as sellers compete for buyers. This describes 2008/2009 when the real estate market crashed, banks went out of business and tons of foreclosure and short sale properties were put up for sale, driving prices and home values down.

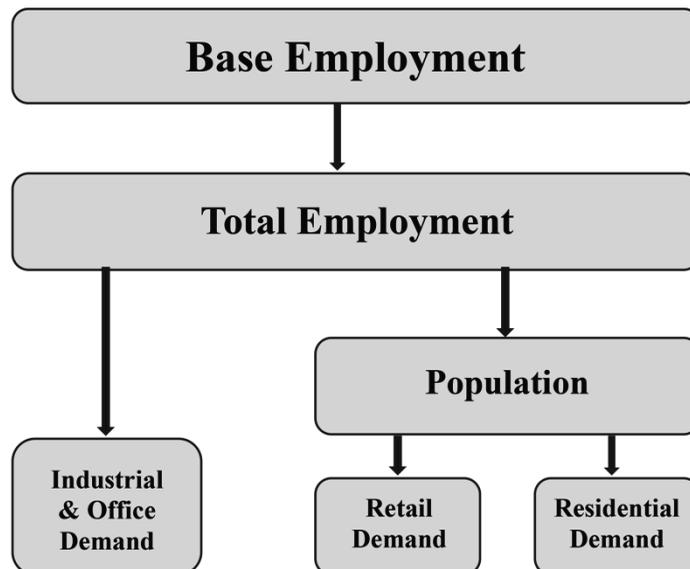
What happened afterwards was a huge decline in home building. According to the Federal National Mortgage Association (FNMA or Fannie Mae), by 2019 our country had a shortage of 3.8 million homes for sale or rent (Hayward, 2022). This, coupled with historically low mortgage interest rates that made borrowing money very attractive, had sellers experiencing above-list-price and multiple-offer situations in 2021 and 2022 and, in many areas, double-digit appreciation, meaning home values increased substantially solely through market dynamics. Remember, when the number of homebuyers stays constant but the number of homes available to purchase goes down, prices go up as buyers compete for the few homes now available.

Here's another example: if the number of homes stays constant but a new company comes to town, bringing many employees with it, prices will go up as buyers compete for the available homes. If the number of homes stays constant but a military base closes and people relocate, prices go down as sellers compete for the buyers who remain.

To assess price movement, the supply and demand of a product or service must always be considered together. However, it is always possible for demand and supply to rise and fall together at the same rate, with no resulting detectable price change.

Since demand is the amount of properties buyers and tenants wish to acquire by purchase, lease or trade at any given time, then what affects demand? The most important factor that drives demand for real estate of all types in a market is **employment** - base employment and total employment. **Base employment** is defined as the number of employed people in businesses that comprise the economic foundation of an area. In Colorado Springs, Colorado we could say that the military is the base employer as there are numerous military installations, organizations and even a military academy in the area. In Northern California, the base employer would be high technology. The automobile industry has traditionally been the base employer in Detroit.

**Total employment** includes not only base employment but secondary and support industries as well. With jobs come commercial and industrial facilities such as office buildings or warehouses; retail businesses like restaurants, shopping and dry cleaners to support workers; and residential neighborhoods to house them. When jobs dry up (a factory or military base closes) then demand for all of these types of real estate evaporates.



In addition to the influences of demand and the underlying determinants of value, real estate supply responds to development costs, particularly **labor**. When copper and lumber prices rise, the costs to build new homes rise as well, causing some builders to stop building and lowering supply. The availability of financing and return on investment impact builders' ability to build homes, office buildings and other types of real estate. Additionally, a community's master plan influences the types and quantity of homes that can be built. Lastly, government police powers and regulation play a part.

A market tends toward a state of **equilibrium** in which supply equals demand, and price, cost and value are identical. According to this principle, market demand moves to meet supply, and supply moves to meet demand. If there is an extreme shortage of an item for which there is normally a strong demand, suppliers will rush to increase production to close the gap. If inventories of an item are very high, suppliers will stop production until the oversupply has been depleted.

There is always a time lag between a recognized imbalance and the completion of the market adjustment. If demand is high and supply is low, homeowners often hesitate to sell (in the absence of external factors like job relocations) because once they do, they themselves become buyers in a low-supply market. This cycle tends to keep equilibrium at bay until confidence rises, new construction can fill the gap and equilibrium can occur.

Other factors also impact equilibrium:

- **Inherent Product Value** - Land is a scarce resource as well as a required factor of production.
- **Unique Appeal of Product** - Since no two parcels of real estate can be alike (each has a different location), every parcel of real property has its own appeal. Likewise, no two parcels of real estate can have exactly the same value (except by coincidence).
- **Demand Must Come to the Supply** - real property investors and users must come to the supply.
- **Illiquid** - Real estate is a relatively illiquid economic product, meaning it cannot always be readily sold for cash. Turning a

house into money takes weeks if not months to accomplish.

- **Slow to Respond to Changes** - Real estate is relatively slow to respond to market imbalances. It takes months to build a house, let alone a subdivision.
- **Decentralized, Local Market** - Real estate markets are local in nature and highly susceptible to swings in the local economy.

Two other concepts are worthy of mention. **Vacancy** is the amount of total real estate inventory of a certain type that is unoccupied at a given time. When office buildings stand relatively empty, that level of vacancy indicates supply is high and demand is low in that area. The opposite is **absorption** or the amount of available property that becomes occupied over a period of time. Another way to look at absorption is month's supply of housing, or how long it will take to sell the current number of available properties based on the rate at which those properties are selling.

Local factors weigh heavily in local real estate market conditions. Among these are the cost of financing, availability of developable land, construction costs, the capacity of the municipality's infrastructure to handle growth, governmental regulation and police powers, changes in the economic base, and in- and out-migrations of major employers. However, regional and national economic forces also influence the local real estate market in the form of changes in the money supply, interest rates, inflation and other national economic cycles.

## ***Other Economic Principles***

Supply and demand aren't the only economic principles that impact real estate. **Anticipation** describes how value can increase or decrease in anticipation of some future benefit or detriment that will affect the property. When a new employer builds a facility, rents in surrounding retail or residential properties rise. People tend to buy homes in "good" school districts, anticipating that those properties' values will increase at a higher rate than those in school districts that don't have the same test scores or funding.

The theory of **substitution** says that a buyer will pay no more for a property than the buyer would have to pay for an equally desirable and available substitute property. All things considered, one three-bedroom, two-bath, two-car-garage, two-story home with 1700 square feet should be worth the same amount as any other similar home in the same neighborhood. They could be substituted for each other.

Many homeowners struggle with the theory of **contribution**, which focuses on the degree to which a particular improvement affects market value of the overall property. In Southern California, people tend to assume that a house has a pool. In Colorado, having a pool could actually lower a home's value. A homeowner who replaces her roof wants to increase the sales price of her home by what she spent; however, most buyers assume that every house comes with a roof. Upgrading a kitchen with \$15,000 worth of granite counters and stainless-steel appliances doesn't necessarily equate to a property now worth \$15,000 more than others in the neighborhood.

The principle of **change** describes how fluctuations in market conditions and neighborhood may either positively or negatively affect property values. When a shopping center or hospital is built, surrounding homes may find their values increase.

Theoretically there is a single use for a property that produces the greatest income and return. This is called **highest and best use**. Think of a street that has mixed-use zoning with some houses and some small businesses like attorneys' offices or family restaurants. The highest and best use for a house on that street may actually be as a business.

Not surprisingly, a property's maximal value is attained when its form and use are in tune with surrounding properties and uses. The theory of **conformity** says that when a property conforms to others around it, it's more valuable. In a community of single-story homes, the two-story property sticks out and is less valuable.

There's a saying that one should always buy the smallest home in a neighborhood because the increased value of the larger homes pulls the value of the smaller home up. We call this **progression**; the worth of a lesser property tends to increase if it is located among better properties. Conversely, **regression** states that the worth of a better property is affected adversely by

the presence of a lesser-quality property. The value of the largest home in the neighborhood is pulled down by the smaller homes around it.

Lastly, depending on the area, plots of land are either more valuable the larger they are or the smaller they are. **Assemblage** describes how the combining of adjacent properties sometimes creates a combined value that is greater than the values of the properties individually. Two lots listed at \$20,000 per half acre each may be worth \$50,000 as a full-acre lot. The difference in value is called **plottage**. In the above example, the plottage value is \$10,000 ( $\$50,000 - (\$20,000 \times 2)$ ).

---

## Appraisals

---

An **appraisal** is an opinion of value or a detailed estimate of a property's value usually utilized to determine market value. **Market value** is defined as the most probable price a property will bring in a competitive market where the buyer and seller are under no pressure to act and payment is made in cash or a cash equivalent. Therefore, the goal of every appraiser is to identify a property's market value.

**Value** is defined as the present worth of future benefits arising from the ownership of real property. There are many different types of value:

- **Assessed Value** – usually a percentage of market value to establish a property tax.
- **Insurable Value** – replacement cost of a building minus the land value.
- **Book Value** – value of an asset less depreciation as it appears on the accounts of the owner.
- **Salvage Value** – estimated value of an asset at the end of its economic life.

- **Reproduction Value** – value based on the cost of constructing a precise duplicate of the property assuming current construction costs.
- **Replacement Value** - value based on the cost of constructing a functional equivalent of the subject property assuming current construction costs.
- **Condemned Value** – Value set by a county or municipal authority for a property being taken by eminent domain.
- **Depreciated Value** – Value established by subtracting accumulated depreciation from the purchase price of the property.
- **Rental Value** – estimate of a rental rate a property can command for a specific period of time.

Appraisers follow specific procedures to collect, organize and analyze the necessary data to produce an appraisal report. Here are the steps in the appraisal process:

1. Identify the purpose.
2. Identify the subject property.
3. Identify the interest in the property to be appraised.
4. Specify the purpose of the appraisal.
5. Specify the date for which the appraisal is valid.
6. Identify the type of value to be estimated.
7. Assimilate the relevant data.
8. Collect data on the subject property through physical inspection and tax and title records.
9. Collect data on the market which includes environmental, demographic and economic issues that affect the neighboring community and region.
10. Assess the Highest and Best Use.
11. Analyze market conditions to determine the most profitable use for the subject property. May or may not be the existing use.
12. Estimate the value of the land.
13. Compare the subject site (without improvements) to similar sites in the area, adjusting for differences. Apply the three approaches to estimating value and then reconcile the value from the approaches, weighing the appropriateness of a particular approach over the others.
14. Compile the report.
15. Present the estimate of value in the format request by the client.

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) requires appraisals be completed by a state-licensed appraiser for all federally related transactions having a transaction value of \$250,000 or more.

## *Sales Comparison or Market Data Approach*

Appraisers use three approaches or methods to determine market value. Considered the most reliable of the three for residential real estate, the **sales comparison or market data approach** compares the **subject property** (for which market value is currently unknown) with recent sales of **comparable properties**. The theory of substitution is at play. If the sold homes were like the subject, then with a little math the appraiser can determine what the subject home would sell for. The theory of contribution is also important here. Sales prices of comparable properties are adjusted to better reflect the characteristics of the subject property, i.e., how does the fireplace contribute to value.

Of course, since every property is unique, appraisers must find the most appropriate comparable sold properties. Comparable properties utilized should be “arm’s length” transactions between normal sellers and buyers (i.e. not foreclosures, auction, sales to relatives, etc.). Once the appraiser has found the most comparable sales, those sales may be adjusted in four areas:

- **Date of sale** – The more recent the sale, the more accurate the information. If a good comparable sale occurred six months ago, that information may not accurately reflect current value, particularly in a quickly appreciating or depreciating market, causing the appraiser to make an adjustment.
- **Location** – The closer the comparable sale to the subject, the better it reflects the value of the subject. Lack of comparables close to the subject may require an appraiser to look in other areas and make an adjustment to value.
- **Physical characteristics** – Appraisers will make adjustments to comparables based on age of the home, square footage, size of the

lot, condition, amenities, upgrades and other property characteristics.

- **Terms of sale** – Unusual financing terms such as seller financing or assumed loans may affect the sale price and therefore warrant an adjustment of value.

*Note: Because the sold price of the comparable property is known, we only adjust the values of the comparables to make them more like the unknown subject.*

If the comparable is **BETTER** than the subject,  
value is subtracted from the comparable.

If the comparable is **WORSE** than the subject,  
value is added to the comparable.

For example, if the subject property has 2,000 square feet and the comparable property has 1,800 square feet, the appraiser will **INCREASE** the value of the comparable by the dollar amount that represents 200 square feet, making the comparable more like the subject. If the subject property doesn't have a fireplace but the comparable does, the appraiser will **DECREASE** the dollar amount that represents a fireplace, making the comparable more like the subject.

Appraisers will typically look for at least three comparables, make adjustments as needed, then analyze the data to determine market value for the subject.

## *Adjusting the Comparables*

In this example, the subject property has 2000 square feet of living space, 2 bathrooms, a 2-car garage and no fireplace. The appraiser has chosen three comparable properties for which they will need to make adjustments in order to make the comparables as much like the subject property as possible.

Subject	Comp 1	Comp 1 Adjustment	Comp 2	Comp 2 Adjustment	Comp 3	Comp 3 Adjustment
2000 s.f.	2500 s.f.		2100 s.f.		1850 s.f.	
2 baths	3 baths		2 baths		2 baths	
2-car garage	3-car garage		2-car garage		1-car garage	
No fireplace	No fireplace		No fireplace		Fireplace	
	Sold - \$330,000		Sold - \$300,000		Sold - \$285,000	

Assuming that the value of a bathroom is \$10,000, a garage bay is \$7,500, a fireplace is \$3,500 and finished square footage is \$35/sf, utilize the sales comparison approach to determine market value for the following subject property:

Subject	Comp 1	Comp 1 Adjustment	Comp 2	Comp 2 Adjustment	Comp 3	Comp 3 Adjustment
2000 s.f.	2500 s.f.	$\$35 \times 500 = -\$17,500$	2100 s.f.	$\$35 \times 100 = -\$3,500$	1850 s.f.	$\$35 \times 150 = +\$5,250$
2 baths	3 baths	-\$10,000	2 baths	0	2 baths	0
2-car garage	3-car garage	-\$7,500	2-car garage	0	1-car garage	+\$7,500
No fireplace	No fireplace	0	No fireplace	0	Fireplace	-\$3,500
	Sold - \$330,000	<b>\$295,000</b>	Sold - \$300,000	<b>\$296,500</b>	Sold - \$285,000	<b>\$294,250</b>

The best comp has the fewest number of and dollar amount in adjustments, therefore the appraiser would weight Comp 2 the highest and determine market value at \$296,500.

## ***Cost Approach (Summation Approach)***

The second appraisal approach is the **cost approach**. This method is most reliable for new or special-purpose buildings, such as churches or schools, where it would be difficult to find recent sales of comparable buildings. Instead, the appraiser determines what it would take to build the special-purpose structure today.

The Steps in the Cost Approach:

1. Estimate the land value using the sales comparison or market data approach.
2. Estimate the cost to build any existing improvements today.
3. Estimate and subtract accrued depreciation from the cost to build new.
4. Add in the land value.

Based on the steps above, it is obvious that an appraiser only depreciates the improvements, not the land. That's because *land does not depreciate*, only improvements on the land like houses, sheds, theaters, etc. do. This is a fundamental concept that bears memorizing. It's not that land prices don't go down, it's that land is not depreciated based on age or other factors that we will get to shortly.

Once the land value is determined, an appraiser can next choose to estimate the cost to build any improvements today using either reproduction cost or replacement cost. **Reproduction cost** is the cost to build the improvement exactly as it is now (think "clone" or "carbon copy"). This is easy enough to do with a newer building that doesn't have a specialized design. Making a reproduction or an exact copy of a new 4,000sf movie theatre with five screening rooms, two bathrooms with four stalls each and a concession stand can be calculated using building materials' current costs. In cases where making an exact reproduction would be difficult – like an historic home built in 1893 with hand-carved banisters and mantles, lath and plaster walls and a Rumford fireplace – using **replacement cost** is more

appropriate. Here the appraiser would determine the cost to build a functional replacement for this unique structure.

Unless the appraiser is determining value for a brand-new property, he or she will next need to depreciate the cost to build new to reflect the current state of the improvements. **Depreciation** refers to the loss in value of an improvement over time. Appraisers evaluate three primary forms of depreciation: physical deterioration, functional obsolescence, and economic obsolescence.

**Physical deterioration** is the loss of property value because of decay or excessive wear and tear. Examples are a leaking roof, holes in the walls, worn carpet or a termite infestation. Physical deterioration may be curable or incurable depending not on whether the issue can be fixed, but on the cost to make the repair. If the cost to replace the roof is \$22,000 but the value the roof represents is \$15,000, the repair is considered incurable.

Some properties may be **outdated** based on consumers' current needs. **Functional obsolescence** refers to the loss of value in an improved property because of design flaws or failure of the property to meet current standards. Examples could be parking lots that are too small for the building's needs, inadequate bathrooms in a movie theater, outdated plumbing or lighting fixtures, or a small primary bedroom in a residential home. These issues may be curable or incurable.

Lastly, **economic (external) obsolescence** indicates a loss in value because of external factors generally beyond the control of the owner. Consider a waste treatment plant next to a subdivision or houses under the local airport's flight path. Since these issues are outside the property, they are incurable.

In addition, depreciation is assumed to occur at an even rate over a structure's **economic life**. **Straight-line depreciation** is a way to monetize an improvement's loss of value due to its age, where the property's cost is divided by the number of years of its expected economic life to determine the amount of annual depreciation. Assume a \$420,000 property has land value of \$90,000 and an improvement value of \$330,000. If improvements are expected to last 60 years, what is the annual (straight-line) depreciation amount for the improvement? To solve this, divide the \$330,000 improvement value by 60 (years of use expected) = \$5,500 annual

depreciation amount. Now imagine the property was purchased seven years ago. What is the current value of the property? Since we know the annual depreciation amount, multiply  $\$5,500 \times 7 = \$38,500$  reduced value of the improvement. So,  $\$330,000 - \$38,500 = \$291,500$  current value of the improvement, plus  $\$90,000$  value of the land (since land does not depreciate) equals a current value of the property of  $\$381,500$ .

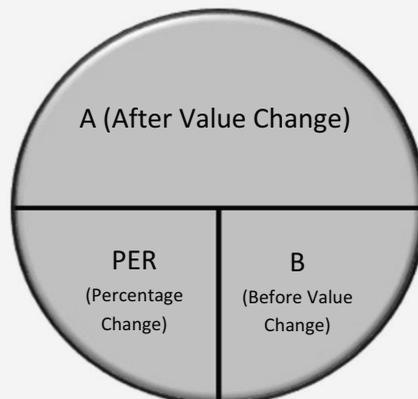
### Math - Calculating Appreciation/Depreciation

While straight-line depreciation is a simple calculation, sometimes the question is what the original purchase price was or the depreciated value will be years in the future. For those questions, use the following formula:

$$\text{After Value} = (100\% \text{ +/-} \text{ Appreciation/Depreciation PERcentage Rate} \times \text{Before Value}$$

Using an acronym for this formula, we call it the AperB formula.

**A = After Value Change**      **PER = Percentage Change**      **B = Before Value Change**



Formula percentage will be an amount in relation to 100%.

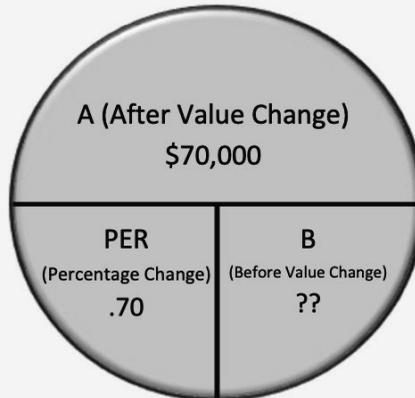
If a question says “15% profit” or “15% appreciation,” enter  $100\% + 15\%$  or  $1.00 + .15 = 115\%$  (1.15) in the PER part of the circle formula.

15% loss or depreciation would be shown as  $100\% - 15\%$  or  $1.00 - .15 = 85\%$  (.85)

**Question 1 – A property has been depreciating at 3% per year. If it is valued at \$70,000 today, what was it worth 10 years ago?**

**Step 1** – Calculate the rate of depreciation. 3% per year x 10 years = 30% depreciation.  
100% - 30% (depreciation) or 1.00 - .30 = .70

**Step 2** – Draw the Circle Formula and place the information that you know in the Appropriate parts of the formula.

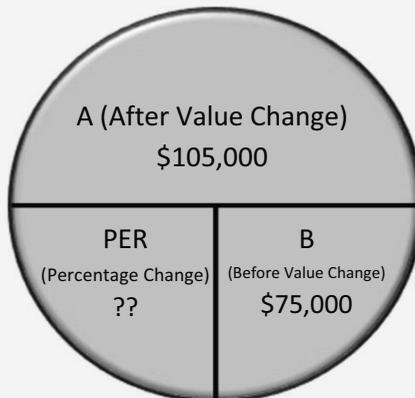


The formula instructs you to divide the After Value Change by the Percentage.

$\$70,000 \div .7 = \$100,000$  (Value before the change).

**Question 2 – A property that was purchased for \$75,000 was later sold for \$105,000. What was the profit percent realized.**

**Step 1** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.



The formula instructs you to divide the After Value by the Before Value.

$\$105,000 \div 75,000 = 1.4$  or 140% (Percentage Change).

## Cost Approach Illustration

<b><u>LAND VALUE</u></b>	
Land Value (by Sales Comparison)	\$82,000
<b><u>IMPROVEMENT COST</u></b>	
Main Building (by replacement cost)	\$325,000
Other Structures	\$48,000
Total cost new	<b>\$373,000</b>
<b><u>ACCRUED DEPRECIATION</u></b>	
Physical Depreciation	
Curable	\$7,000
Incurable	\$2,000
Functional Obsolescence	\$11,000
External Obsolescence	\$0
Total depreciation	<b>\$20,000</b>
<b><u>IMPROVEMENTS COST MINUS DEPRECIATION</u></b>	
Total cost new	\$373,000
Less: total depreciation	\$20,000
Depreciated value of improvements	<b>\$353,000</b>
<b><u>OVERALL ESTIMATED VALUE</u></b>	
Total land value	\$82,000
Depreciated value of improvements	\$353,000
<b>VALUE BY COST APPROACH</b>	<b>\$435,000</b>

## *Income Analysis Approach*

The most reliable approach for income-producing property, the **income approach** is based on the present value of the rights to future income. The appraiser follows a formula to calculate the **Net Operating Income**, a measure of the profitability of a real estate investment that is then used to examine the underlying cash flows of an investment before the effects of taxes and financing costs are considered.

Calculation of net operating income is done by subtracting all operating expenses from the revenues generated by a specific property.

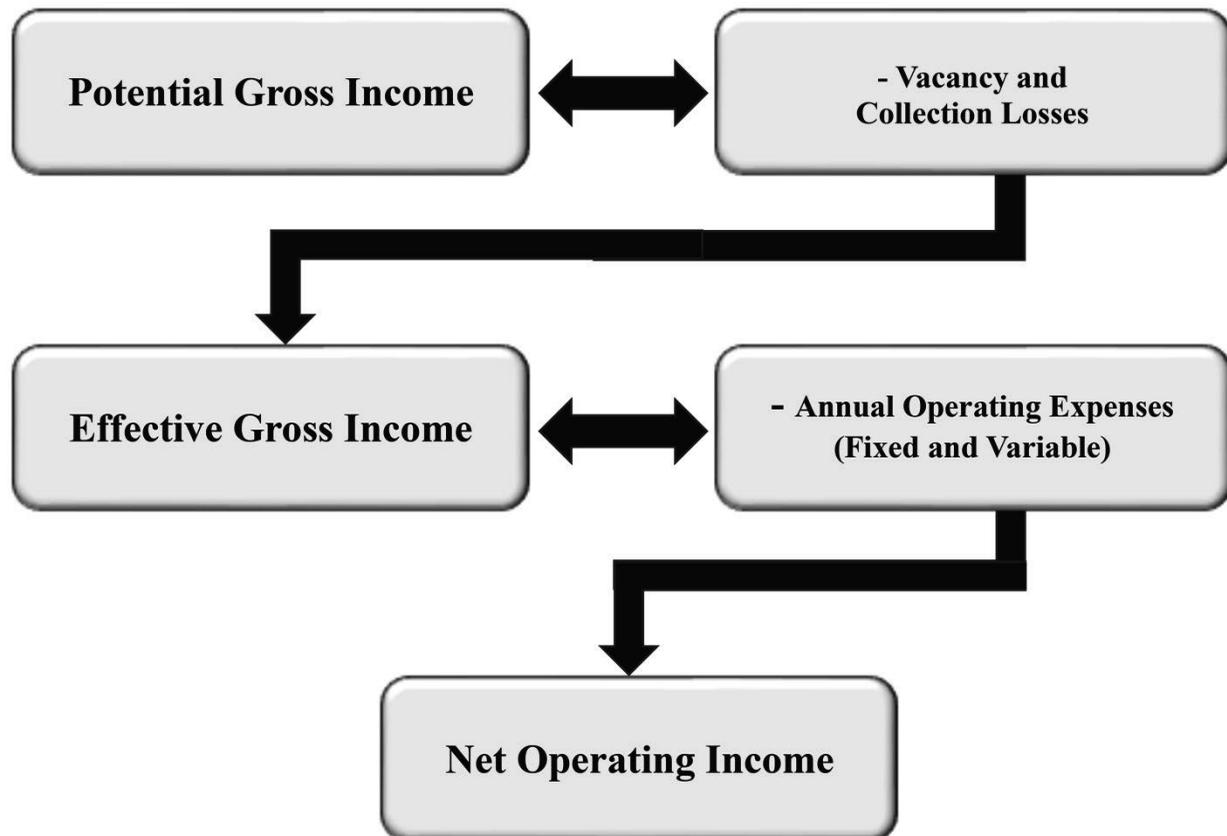
$$\text{Revenues generated} - \text{Operating Expenses} = \text{Net Operating Income.}$$

**Revenues** can include facility rental, vending proceeds, laundry proceeds, parking fees, service charges and more. An apartment building may generate rental income from each unit as well as income from vending machines and coin-operated washing machines and dryers. And, of course, not all properties are fully rented 100% of the time. Additionally, sometimes tenants don't pay the rent. These situations are taken into consideration based on local market conditions.

**Operating expenses** associated with real estate are often **variable** expenses (those generated through operations like repairs, management fees, utilities or janitorial services), and **fixed** expenses that happen whether the property is occupied or vacant (property taxes and property insurance). Income taxes and interest expense in monthly mortgage payments are not considered operating expenses.

The Steps in the Income Approach:

1. Determine the Potential Gross Income (maximum revenue possible from all sources).
2. Subtract all vacancy and collection losses. (Effective Gross Income)
3. Calculate all annual operating expenses (fixed and variable).
4. Subtract all Annual Operating Expenses from Effective Gross Income. (Net Operating Income)
5. Determine Capitalization Rate
6. Apply Capitalization rate to Net Operating Income.



Appraisers and investors alike are concerned with a property's NOI because it is integral in determining value or how much an investor can pay for a property and earn a desired return. The **Capitalization Rate** is an estimate of the rate of return (ROI) an investor will demand on the investment of capital in a property. Some investors want a 6% return on their investment (6% cap rate) while other investors may demand an 8% return on their money. The capitalization rate is really what the investor wants. Understanding this helps an investor decide how much he or she can invest in a given property and still get their desired rate of return. An investor can also determine what the actual capitalization rate was on an investment to see how well that real estate purchase performed.

Appraisers will usually research capitalization rates on similar properties in the market by comparing the relationship between net operating income and sales price.

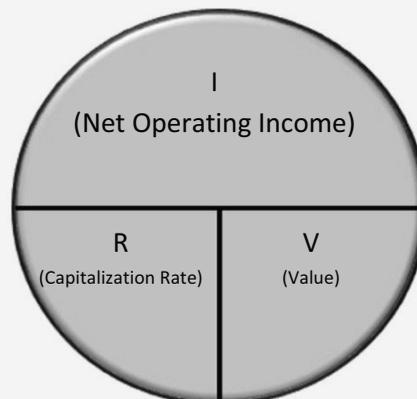
### Math - Calculating Income Approach To Value

Once the appraiser has calculated the Net Operating Income and identified the capitalization rate for similar properties in the area, he or she can determine the value of the subject using the below formula:

$$\text{Value} = \text{Capitalization Rate} \times \text{NOI}$$

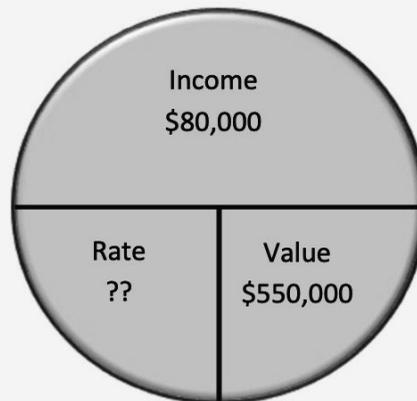
Using an acronym for this formula, we call it the IRV formula.

**I = Net Operating Income**      **R = Capitalization Rate**      **V = Value**



**Question 1 – An appraiser is trying to determine the best cap rate to use to determine value on a subject property. The subject is a small apartment complex that produces an annual net income of \$80,000. A similar property sold for \$550,000. What was that property’s capitalization rate?**

**Step 1** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.

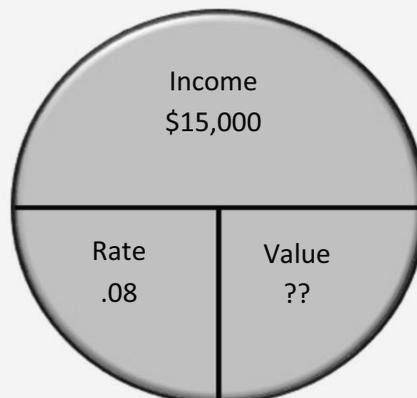


The formula instructs you to divide the Income by the Value.

$$\$80,000 \div \$550,000 = .14545 \text{ or } 14.5\%$$

**Question 2 – An investor wants to purchase a property that generates \$15,000 in annual net income, but only if she can realize an 8% return on that purchase. How much can she spend and get her desired cap rate.**

**Step 1** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.



The formula instructs you to divide Income by the Rate.

$$\$15,000 \div .08 = \$187,500 \text{ (Value needed to obtain desired cap rate).}$$

## Income Capitalization Method Illustration

<b><u>ESTIMATE POTENTIAL GROSS INCOME</u></b>	
Potential Gross Rental Income	\$124,000
All Other Income Sources	\$15,000
Potential Gross Income	<b>\$139,000</b>
<b><u>ESTIMATE EFFECTIVE GROSS INCOME</u></b>	
Less Vacancy and Collection Losses	\$5,700
Effective Gross Income	\$133,300
<b><u>ESTIMATE NET OPERATING INCOME</u></b>	
Operating Expenses	
Real Estate Taxes	\$4,500
Insurance	\$3,200
Utilities	\$11,000
Repairs and Maintenance	\$6,000
Management	\$18,000
Reserves	\$15,000
Legal and Professional	\$2,500
Total Expenses	<b>\$60,200</b>
Effective Gross Income	\$133,300
Less: Total Expenses	-\$60,200
Net Operating Income	<b>\$73,100</b>
<b><u>SELECT AND APPLY CAPITALIZATION RATE</u></b>	
Capitalization Rate:	10%
<b><math>\\$73,100 \div .10 = \\$731,000</math></b>	

A higher capitalization rate will lower the value estimate. A lower capitalization rate will increase the value estimate. Restated, the higher the investor's expectations or desired rate of return, the less money he or she can invest in a property.

**The lower the capitalization rate – the greater the value.  
(The lower the risk, the greater the value.)**

**The higher the capitalization rate – the lesser the value.  
(The higher risk forces the value down.)**

## *Alternatives to the Income Approach*

Used as a substitute for the income approach when appraising a residential property, which is defined as a single-family rental home up to a four-unit complex, the **Gross Rent Multiplier (GRM)** or GRM method is based on **monthly** rental income. It allows the appraiser to identify a factor many similar rented properties to calculate a rough approximation of value. Gross rent multipliers are averaged to determine an acceptable GRM for the subject property.

$$\text{GRM (Gross Rent Multiplier)} = \text{Sales Price} \div \text{MONTHLY Rent}$$

For example, an appraiser is trying to determine the value of a property using GRM. First, she must compile data on recently sold comparable properties and their monthly rental income amounts.

Property	Sales Price	Monthly Rent	GRM (rounded)
123 Main Street	\$330,000	\$1,950	169
444 Lincoln Street	\$325,000	\$1,875	173
2121 Town Avenue	\$320,000	\$1,900	168
AVERAGE			<b>170</b>

Next, to determine value, the appraiser multiplies the monthly rental income on the subject, let's say \$2000, times the calculated GRM of 170. The GRM appraised value would be \$340,000.

Similarly, **Gross Income Multiplier (GIM)** is used as a quick way to appraise commercial and industrial properties. Like the GRM method, Gross Income Multipliers are compiled to determine an acceptable GIM for the subject property. GIM is usually used on residential property with more than five units, which classifies it as non-residential. One major difference between GRM and GIM is that GIM is based on *annual* rental income, not monthly rental income.

$$\text{GIM (Gross Income Multiplier)} = \text{Sales Price} \div \text{ANNUAL Rent}$$

A commercial building that sold for \$500,000 with an *annual* rental income of \$60,000 has a GIM of 8.3. So, if an appraiser is trying to determine value for a commercial property and there are several available comps with known GIMs, multiplying the GIM assigned to a property by its annual rental income will give an estimated market value. Therefore, using a GIM of 10 on a property with annual rental income of \$35,000 would provide an estimated market value of \$350,000.

Property	Sales Price	Annual Rent	GIM (rounded)
543 Sycamore Street	\$750,000	\$82,000	9.15
982 W. Jefferson Street	\$843,000	\$98,000	8.60
437 Town Center Drive	\$645,000	\$71,000	9.08
AVERAGE			<b>8.94</b>

*In general, Gross Rent Multiplier numbers are large and Gross Income Multiplier numbers are small.*

## *What Happens Next*

Remember, once the appraiser has applied all three techniques – Sales Comparison/Market Data, Cost and Income Approach – he or she will then weigh the appropriateness of each to the property being evaluated and determine the appraised value. The appraiser doesn't average all three together. This **reconciliation** of the outcomes of all three approaches takes the quantity and quality of the data used into consideration. Lastly, a report that documents all this research is generated.

**An example of the first three pages of the Uniform Residential Appraisal Report are found on the next pages.**

# Uniform Residential Appraisal Report

File # \_\_\_\_\_

The purpose of this summary appraisal report is to provide the lender/client with an accurate, and adequately supported, opinion of the market value of the subject property.

Property Address \_\_\_\_\_ City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Borrower \_\_\_\_\_ Owner of Public Record \_\_\_\_\_ County \_\_\_\_\_

Legal Description \_\_\_\_\_

Assessor's Parcel # \_\_\_\_\_ Tax Year \_\_\_\_\_ R.E. Taxes \$ \_\_\_\_\_

Neighborhood Name \_\_\_\_\_ Map Reference \_\_\_\_\_ Census Tract \_\_\_\_\_

Occupant  Owner  Tenant  Vacant \_\_\_\_\_ Special Assessments \$ \_\_\_\_\_  PUD HOA \$ \_\_\_\_\_  per year  per month

Property Rights Appraised  Fee Simple  Leasehold  Other (describe) \_\_\_\_\_

Assignment Type  Purchase Transaction  Refinance Transaction  Other (describe) \_\_\_\_\_

Lender/Client \_\_\_\_\_ Address \_\_\_\_\_

Is the subject property currently offered for sale or has it been offered for sale in the twelve months prior to the effective date of this appraisal?  Yes  No

Report data source(s) used, offering price(s), and date(s). \_\_\_\_\_

---

I did  I did not analyze the contract for sale for the subject purchase transaction. Explain the results of the analysis of the contract for sale or why the analysis was not performed. \_\_\_\_\_

---

Contract Price \$ \_\_\_\_\_ Date of Contract \_\_\_\_\_ Is the property seller the owner of public record?  Yes  No Data Source(s) \_\_\_\_\_

Is there any financial assistance (loan charges, sale concessions, gift or downpayment assistance, etc.) to be paid by any party on behalf of the borrower?  Yes  No

If Yes, report the total dollar amount and describe the items to be paid. \_\_\_\_\_

---

**Note: Race and the racial composition of the neighborhood are not appraisal factors.**

Neighborhood Characteristics		One-Unit Housing Trends			One-Unit Housing	Present Land Use %
Location <input type="checkbox"/> Urban <input type="checkbox"/> Suburban <input type="checkbox"/> Rural	Property Values <input type="checkbox"/> Increasing <input type="checkbox"/> Stable <input type="checkbox"/> Declining	PRICE	AGE	One-Unit	%	
Built-Up <input type="checkbox"/> Over 75% <input type="checkbox"/> 25-75% <input type="checkbox"/> Under 25%	Demand/Supply <input type="checkbox"/> Shortage <input type="checkbox"/> In Balance <input type="checkbox"/> Over Supply	\$ (000)	(yrs)	2-4 Unit	%	
Growth <input type="checkbox"/> Rapid <input type="checkbox"/> Stable <input type="checkbox"/> Slow	Marketing Time <input type="checkbox"/> Under 3 mths <input type="checkbox"/> 3-6 mths <input type="checkbox"/> Over 6 mths	Low		Multi-Family	%	
Neighborhood Boundaries _____		High		Commercial	%	
		Med.		Other	%	

Neighborhood Description \_\_\_\_\_

Market Conditions (including support for the above conclusions) \_\_\_\_\_

---

Dimensions \_\_\_\_\_ Area \_\_\_\_\_ Shape \_\_\_\_\_ View \_\_\_\_\_

Specific Zoning Classification \_\_\_\_\_ Zoning Description \_\_\_\_\_

Zoning Compliance  Legal  Legal Nonconforming (Grandfathered Use)  No Zoning  Illegal (describe) \_\_\_\_\_

Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use?  Yes  No If No, describe \_\_\_\_\_

---

Utilities Public Other (describe) \_\_\_\_\_ Public Other (describe) \_\_\_\_\_ Off-site Improvements—Type Public Private

Electricity   \_\_\_\_\_ Water   Street

Gas   \_\_\_\_\_ Sanitary Sewer   Alley

FEMA Special Flood Hazard Area  Yes  No FEMA Flood Zone \_\_\_\_\_ FEMA Map # \_\_\_\_\_ FEMA Map Date \_\_\_\_\_

Are the utilities and off-site improvements typical for the market area?  Yes  No If No, describe \_\_\_\_\_

Are there any adverse site conditions or external factors (easements, encroachments, environmental conditions, land uses, etc.)?  Yes  No If Yes, describe \_\_\_\_\_

---

General Description	Foundation	Exterior Description	materials/condition	Interior	materials/condition
Units <input type="checkbox"/> One <input type="checkbox"/> One with Accessory Unit	<input type="checkbox"/> Concrete Slab <input type="checkbox"/> Crawl Space	Foundation Walls		Floors	
# of Stories _____	<input type="checkbox"/> Full Basement <input type="checkbox"/> Partial Basement	Exterior Walls		Walls	
Type <input type="checkbox"/> Det. <input type="checkbox"/> Att. <input type="checkbox"/> S-Det./End Unit	Basement Area _____ sq. ft.	Roof Surface		Trim/Finish	
<input type="checkbox"/> Existing <input type="checkbox"/> Proposed <input type="checkbox"/> Under Const.	Basement Finish _____ %	Gutters & Downspouts		Bath Floor	
Design (Style) _____	<input type="checkbox"/> Outside Entry/Exit <input type="checkbox"/> Sump Pump	Window Type		Bath Wainscot	
Year Built _____	Evidence of <input type="checkbox"/> Infestation	Storm Sash/Insulated		Car Storage <input type="checkbox"/> None	
Effective Age (Yrs) _____	<input type="checkbox"/> Dampness <input type="checkbox"/> Settlement	Screens		<input type="checkbox"/> Driveway # of Cars	
Attic <input type="checkbox"/> None	Heating <input type="checkbox"/> FWA <input type="checkbox"/> HWBB <input type="checkbox"/> Radiant	Amenities <input type="checkbox"/> Woodstove(s) #		Driveway Surface	
<input type="checkbox"/> Drop Stair <input type="checkbox"/> Stairs	<input type="checkbox"/> Other _____ Fuel	<input type="checkbox"/> Fireplace(s) # <input type="checkbox"/> Fence		<input type="checkbox"/> Garage # of Cars	
<input type="checkbox"/> Floor <input type="checkbox"/> Scuttle	Cooling <input type="checkbox"/> Central Air Conditioning	<input type="checkbox"/> Patio/Deck <input type="checkbox"/> Porch		<input type="checkbox"/> Carport # of Cars	
<input type="checkbox"/> Finished <input type="checkbox"/> Heated	<input type="checkbox"/> Individual <input type="checkbox"/> Other	<input type="checkbox"/> Pool <input type="checkbox"/> Other		<input type="checkbox"/> Att. <input type="checkbox"/> Det. <input type="checkbox"/> Built-in	

Appliances  Refrigerator  Range/Oven  Dishwasher  Disposal  Microwave  Washer/Dryer  Other (describe) \_\_\_\_\_

Finished area above grade contains: \_\_\_\_\_ Rooms \_\_\_\_\_ Bedrooms \_\_\_\_\_ Bath(s) \_\_\_\_\_ Square Feet of Gross Living Area Above Grade \_\_\_\_\_

Additional features (special energy efficient items, etc.) \_\_\_\_\_

Describe the condition of the property (including needed repairs, deterioration, renovations, remodeling, etc.). \_\_\_\_\_

Are there any physical deficiencies or adverse conditions that affect the livability, soundness, or structural integrity of the property?  Yes  No If Yes, describe \_\_\_\_\_

Does the property generally conform to the neighborhood (functional utility, style, condition, use, construction, etc.)?  Yes  No If No, describe \_\_\_\_\_

# Uniform Residential Appraisal Report

File # \_\_\_\_\_

There are comparable properties currently offered for sale in the subject neighborhood ranging in price from \$ _____ to \$ _____		There are comparable sales in the subject neighborhood within the past twelve months ranging in sale price from \$ _____ to \$ _____	
FEATURE	SUBJECT	COMPARABLE SALE # 1	COMPARABLE SALE # 2
Address			
Proximity to Subject			
Sale Price \$ _____ \$ _____ \$ _____ \$ _____			
Sale Price/Gross Liv. Area \$ _____ sq. ft. \$ _____ sq. ft. \$ _____ sq. ft. \$ _____ sq. ft.			
Data Source(s)			
Verification Source(s)			
VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) \$ Adjustment
Sale or Financing Concessions			
Date of Sale/Time			
Location			
Leasehold/Fee Simple			
Site			
View			
Design (Style)			
Quality of Construction			
Actual Age			
Condition			
Above Grade	Total Bdms. Baths	Total Bdms. Baths	Total Bdms. Baths
Room Count			
Gross Living Area	sq. ft.	sq. ft.	sq. ft.
Basement & Finished Rooms Below Grade			
Functional Utility			
Heating/Cooling			
Energy Efficient Items			
Garage/Carport			
Porch/Patio/Deck			
Net Adjustment (Total)	<input type="checkbox"/> + <input type="checkbox"/> -	<input type="checkbox"/> + <input type="checkbox"/> -	<input type="checkbox"/> + <input type="checkbox"/> -
Adjusted Sale Price of Comparables	Net Adj. % Gross Adj. %	Net Adj. % Gross Adj. %	Net Adj. % Gross Adj. %
<input type="checkbox"/> I did not research the sale or transfer history of the subject property and comparable sales. If not, explain _____			
<input type="checkbox"/> My research did not reveal any prior sales or transfers of the subject property for the three years prior to the effective date of this appraisal.			
<input type="checkbox"/> My research did not reveal any prior sales or transfers of the comparable sales for the year prior to the date of sale of the comparable sale.			
Report the results of the research and analysis of the prior sale or transfer history of the subject property and comparable sales (report additional prior sales on page 3).			
ITEM	SUBJECT	COMPARABLE SALE # 1	COMPARABLE SALE # 2
Date of Prior Sale/Transfer			
Price of Prior Sale/Transfer			
Data Source(s)			
Effective Date of Data Source(s)			
Analysis of prior sale or transfer history of the subject property and comparable sales			
Summary of Sales Comparison Approach			
Indicated Value by Sales Comparison Approach \$ _____			
Indicated Value by: Sales Comparison Approach \$ _____ Cost Approach (if developed) \$ _____ Income Approach (if developed) \$ _____			
This appraisal is made <input type="checkbox"/> "as is", <input type="checkbox"/> subject to completion per plans and specifications on the basis of a hypothetical condition that the improvements have been completed, <input type="checkbox"/> subject to the following repairs or alterations on the basis of a hypothetical condition that the repairs or alterations have been completed, or <input type="checkbox"/> subject to the following required inspection based on the extraordinary assumption that the condition or deficiency does not require alteration or repair:			
Based on a complete visual inspection of the interior and exterior areas of the subject property, defined scope of work, statement of assumptions and limiting conditions, and appraiser's certification, my (our) opinion of the market value, as defined, of the real property that is the subject of this report is \$ _____, as of _____, which is the date of inspection and the effective date of this appraisal.			



## *Competitive/Comparable Market Analysis*

As mentioned before, there are many similarities between the Market Data/Sales Comparison appraisal approach and what real estate professionals do to determine market value, otherwise known as a Comparative (or Competitive) Market Analysis or **CMA**. The primary difference is that while appraisers only consider sold data in an appraisal, licensees look at all neighborhood property data – recent solds, properties currently available for sale, homes that are under contract and even withdrawn or expired listings that did not sell. Additionally, the licensee is compiling information that usually results in a price range that allows the seller to choose an appropriate list price or a buyer to choose an offer price.

Another difference is that while appraisers know how to make adjustments to comps based on the value an additional bathroom or a kitchen remodel contributes, licensees can only use the different prices (sold or list) for different properties to try to isolate the “value” of those characteristics or amenities. Because homes often have many combinations of amenities, it’s very challenging to determine what the adjustment dollar amount should be for one item of difference.

Let’s say you are performing a CMA for a potential seller whose house is a two-story with three bedrooms, three bathrooms, 1,765 sf total but 1361 sf above grade/finished, a two-car garage, a fireplace, A/C, a shed in the backyard and a newly updated kitchen. Your research has uncovered another active listing that is 10 years newer with no fireplace, 1919 sf total and 1550 sf above grade/finished and a kitchen that has not been upgraded. How do you determine how much to adjust for the kitchen upgrade?

While practice certainly helps, this basic truth explains why we provide a price range and let the seller/buyer do with that information what they will. It’s not your job to go to a home improvement store and price out appliances, tile, counter tops, and flooring, or to reach out to a contractor for a bid.

When a bank or lender needs help determining the value of a property, they may request a real estate licensee to provide a Broker Price Opinion (BPO). The BPO may only require a licensee to drive by a property and then follow up with a list of comparable sales, or could be more extensive than a CMA,

requiring photos, neighborhood information and more. Usually, licensees are compensated nominally for their work, although this is not considered by many states to be brokerage services.

Neither a CMA nor a BPO can be utilized as an appraisal for a property being financed through a loan that may be sold on the secondary market (FNMA, FHLMC, etc.); they are not to be used for valuation purposes.

# Chapter 7 Key Point Review

---

## 1. Real Estate Market Economics

- a. The goal of an economic system is to produce and distribute a supply of goods and services to satisfy the demand of its constituents.
  - i. Supply – the quantity of a product or service available at any given time.
  - ii. Demand – the quantity of a product or service that is desired at any given time.
  
- b. Difference between price and value.
  - i. Price – the amount of money or other asset that a buyer will pay and a seller will sell for.
  - ii. Value is determined by:
    - 1. How much something is desired.
    - 2. How useful it is.
    - 3. How scarce it is.
    - 4. If someone can afford it.
  - iii. Components of value:
    - 1. Desire/demand
    - 2. Utility
    - 3. Scarcity
    - 4. Purchasing power
    - 5. Transferability
  
- c. Real Estate Supply and Demand
  - i. If supply increases relative to demand – price decreases
  - ii. If supply decreases relative to demand – price increases
  - iii. If demand increases relative to supply – price increases
  - iv. If demand decreases relative to supply – price decreases
    - 1. The most important factor that drives demand for real estate of all types is employment.
      - a. Base employment – the number of employed people in businesses that comprise the economic foundation of an area.
      - b. Total employment – includes base employment but also secondary and support industries as well.
    - 2. Markets tend toward a state of equilibrium where supply equals demand, and price, cost and value are identical.
  - v. Vacancy and Absorption
    - 1. Vacancy – the amount of total real estate inventory of a certain type that is unoccupied at a given type.
    - 2. Absorption – the amount of available property that become occupied over a period of time.

d. Other Economic Principles

- i. Anticipation – how value can increase or decrease in anticipation of some future benefit or detriment that will affect the property.
- ii. Substitution – a buyer will pay no more for a property than they would pay for an equally desirable and available substitute property.
- iii. Contribution – the amount that a particular improvement affects the market value of a property.
- iv. Change – fluctuations in market conditions and neighborhoods may positively or negatively affect property values.
- v. Highest and Best Use – the single use for a property that produces the greatest income and return.
- vi. Conformity – when a property conforms to others around it, it's more valuable.
- vii. Progression – the worth of a lesser property tends to increase if it is located among better properties.
- viii. Regression – the worth of a better property is affected adversely by the presence of a lesser-quality property.
- ix. Assemblage – the combining of adjacent properties can sometimes create a combined value that is greater than the values of the properties individually.
  1. Plottage is the difference in value.

2. Appraisals

- a. An appraisal is an educated opinion of value used to determine market value.
  - i. Market Value – the most probable price a property will bring in a competitive market.
  - ii. Market Price – the price a property actually sells for.
- b. Many types of value:
  - i. Assessed value – a percentage of market value to establish property tax.
  - ii. Insurable value – replacement cost of a building minus the land value.
  - iii. Book value – value of an asset, less depreciation, as it appears on the accounts of a business/owner.
  - iv. Salvage value – value of an asset at the end of its economic life.
  - v. Reproduction value – value based on the cost of constructing a precise duplicate of a property assuming current construction costs.
  - vi. Replacement value – value based on the cost of constructing a functional equivalent of a property assuming current construction costs.
  - vii. Condemned value – value set by a governmental authority for a property being taken by eminent domain.
  - viii. Depreciated value – value established by subtracting accumulated depreciation from the purchase price of a property.

- ix. Rental value – an estimate of a rental rate a property could command for a specific period of time.
- c. Steps in the appraisal process:
- i. Identify the purpose of the appraisal.
  - ii. Identify the subject property.
  - iii. Identify the interest in the property to be appraised.
  - iv. Specify the purpose of the appraisal.
  - v. Specify the date for which the appraisal is valid.
  - vi. Identify the type of value to be estimated.
  - vii. Assimilate the relevant data.
  - viii. Collect data on the subject property through physical inspection and public records.
  - ix. Collect data on the market.
  - x. Assess the Highest and Best Use.
  - xi. Analyze market conditions to determine the most profitable use for the subject property.
  - xii. Estimate the value of the land.
  - xiii. Compare the site (without improvements) to similar sites in the area, adjusting for differences.
  - xiv. Apply one or more of the three approaches to estimating value: Sales Comparison, Cost or Income approaches.
  - xv. Compile the Report.
  - xvi. Present the estimate of value in the format requested by the client.
- d. Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) requires appraisals be completed by a state-licensed appraiser for all federally related transactions having a transaction value of \$250,000 or more.
- e. Sales Comparison or Market Data Approach
- i. The most reliable of the three approaches to value.
  - ii. Compares the subject property with recent sales of comparable properties.
    - 1. Utilizes the theory of Substitution.
    - 2. Comparable properties utilized should be “arm’s length” transactions.
    - 3. Comparable properties may be adjusted to be more like the subject property in four areas:
      - a. Date of sale – more recent is preferred.
      - b. Location – its location in relation to the subject property.
      - c. Physical characteristics – age, size, square footage, etc.
      - d. Terms of sale – unusual terms or financing
    - 4. Because the sold price of the comparable property is known, adjustments are only made to the value of the comparables to make them more like the subject.

- a. If the comparable is BETTER than the subject, value is subtracted from the comparable.
    - b. If the comparable is WORSE than the subject, value is added to the comparable.
  - 5. Usually, three to four comparables are utilized.
- f. Cost Approach (Summation Approach)
  - i. Most reliable for new or special purpose buildings where it might be difficult to find recent sold comparable properties.
  - ii. Steps in the Cost Approach:
    - 1. Estimate the value of the land value using the sales comparison or market date approach.
    - 2. Estimate the cost to build any existing improvements today.
    - 3. Estimate and subtract accrued depreciation from the improvements.
    - 4. Add the land value.
  - iii. Land never depreciates, only improvements are depreciated.
  - iv. Appraiser utilizes one of two ways to determine improvement values:
    - 1. Reproduction cost – the cost to build an exact duplicate of the property.
    - 2. Replacement cost – the cost to build a functional replacement of the property.
      - a. Most commonly utilized in residential appraisals.
  - v. Appraiser determines depreciation of the improvements. Three different types of depreciation are taken into consideration:
    - 1. Physical deterioration – loss of property value because of decay or excessive wear and tear.
      - a. Can be curable or incurable.
    - 2. Functional obsolescence – properties may be outdated based on consumer’s current needs.
      - a. Can be curable or incurable.
    - 3. Economic (external) obsolescence – loss of value because of external factors generally beyond the owner’s control.
      - a. Are incurable.
    - 4. Depreciation is assumed to occur at an even rate over a structure’s economic life.
    - 5. Straight Line Depreciation – property’s cost is divided by the number of years of its expected economic life to determine the amount of annual depreciation.
- g. Income Analysis Approach
  - i. Most reliable approach for income-producing property.
  - ii. Based off of a property’s Net Operating Income.

1. Revenues generated by real estate – Operating Expenses = Net Operating Income
  - a. Revenues – facility rental, vending proceeds, parking fees, service charges, etc.
    - i. Subject to vacancy and collection losses.
  - b. Expenses
    - i. Variable – repairs, management fees, utilities, etc.
    - ii. Fixed – taxes, insurance.
  - c. Income taxes and interest expense are not considered in operating expenses.
2. Steps in the Income Approach
  - a. Calculate Potential Gross Income
  - b. Subtract vacancy and rent losses – Effective Gross Income
  - c. Subtract annual operating expenses (fixed and variable)
  - d. Obtain Net Operating Income (NOI)
  - e. Apply a Capitalization Rate – the estimated rate of return (ROI) an investor will demand on their investment capital for a property.
  - f. Value of the property = Capitalization Rate x NOI
    - i. If Cap Rate goes up – value goes down.
    - ii. If Cap Rate goes down – value goes up.
3. Alternatives to the Income Approach
  - a. Gross Rent Multiplier (GRM)
    - i. Used when appraising residential property – single family residential up to a four-unit complex.
    - ii. Based on monthly rental income.
    - iii.  $GRM = \text{Sales Price} \div \text{MONTHLY rent}$ .
    - iv. Appraiser identifies a factor of many similar rented properties to calculate a rough approximation of value.
  - b. Gross Income Multiplier (GIM)
    - i. Used when appraising commercial and industrial properties.
    - ii. Based on annual income.
    - iii.  $GIM = \text{Sales Price} \div \text{ANNUAL rent}$ .
    - iv. Appraiser identifies a factor of many similar rented properties to calculate a rough approximation of value.
- h. Competitive/Comparable Market Analysis/Broker Price Opinion
  - i. Very similar to the Market Data/Sales Comparison approach
    1. Utilizes an analysis of recent solds, available for sale, under contract, withdrawn and expired properties.

2. Information compiled usually results in a price range for a seller or buyer to see the potential market value of a property.
  3. Usually, adjustments to comparable properties are not as detailed as an appraiser would perform.
- ii. Broker Price Opinion (BPO) – requested by a bank or lender to determine the value of a property.
  - iii. BPO's or CMA's cannot be utilized as an appraisal for property being financed through a loan that may be sold on the secondary market. (FNMA, FHLMC, etc.)

# Chapter 7 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. An appraisal is an opinion of value.
2. Market value is the actual price a property sells for.
3. Market price is the most probable price a property will sell for.
4. The essential elements of value are Demand, Utility/Usefulness, Stability and Transferability.
5. It is important for the appraiser to know the purpose of the appraisal.
6. The highest and best use of a property will always be its current or existing use.
7. The appraisal reconciliation process may take into consideration all three approaches to value.
8. The principle of highest and best use is the most important among all three approaches.
9. Land has the possibility of depreciating.
10. The sales comparison approach is also known as the market data approach.
11. The principle of supply and demand states that if demand increased for a particular product and supply remains constant then prices should increase.
12. Using the market data approach, adjustments are made to the subject property.
13. The first thing that an appraiser should do when estimating land value is to determine its highest and best use.
14. When considering whether building a swimming pool would increase the property value an appraiser would utilize the principles of conformity to help them in their determination.
15. When three adjacent properties are combined into one to create a higher value (plottage) than the individual sum of the three properties' values, the process is called assemblage.
16. The cost approach is also known as the summation approach.
17. If a comparable is better than the subject property, value is added to the comparable property.
18. The sales comparison approach relies on the principle of Substitution.

19. Progression is the increased worth of a lesser property when located among better properties.
20. Regression is the increased worth of a better property when located among worse properties.
21. The summation approach is the most reliable approach for special-purpose properties.
22. The reproduction cost is the cost to construct an exact replica of the subject's structure.
23. Replacement cost is the cost to construct a structure with the similar usefulness/utility.
24. The current owner's acquisition cost is taken into consideration by the appraiser in estimating the value of a property.
25. The best comparable property for a subject is one that requires the fewest and smallest adjustments be made to it.
26. Estimating accrued depreciation is made in the income approach.
27. Physical deterioration is loss of value to a property that is beyond normal wear and tear.
28. The capitalization approach is also known as the income approach.
29. Deferred maintenance is an example of functional obsolescence.
30. Dividing the new operating income into the capitalization rate will be the value of a property in the income approach.
31. Dividing the net operating income into the capitalization rate will be the value of a property in the income approach.
32. Assemblage is the process of conjoining adjacent properties which can create a combined value that is greater than the values of the properties individually.
33. Plottage is the value of conjoined adjacent properties through the process of Assemblage.
34. In the sales comparison approach, the adjustments are made to the subject property.
35. In the market data approach, when the comparable is better than the subject, value is added to the comparable.
36. In the market data approach, when the comparable is worse than the subject, value is added to the comparable.
37. An appraiser will use the summation approach when finding the value of new construction.

38. The best comparable property to use is one that requires the most and largest adjustments.
39. The capitalization approach will be the best method to use on unimproved land.
40. The GRM method of valuation is best used for single family rentals.
41. The first step in the appraisal process is to define the purpose of the appraisal.
42. When reconciling the appraisal, the appraiser averages all three approaches to value.
43. The capitalization approach relies heavily on the Net Operating Income.
44. The NOI on an apartment building is \$14,400. With a desired 12% cap rate, the most an investor would pay for the building is \$1,200,000.
45. A property has a GIM of 15 with a monthly rent of \$1,000. The indicated value of the property would be \$16,500.
46. Physical deterioration is normally a curable depreciation.
47. Economic obsolescence is also known as location obsolescence and/or external obsolescence.
48. Within the income approach, the higher the cap rate, the higher the value.
49. A property has a GRM of 150 with a monthly rent of \$3,000. The indicated value of the property would be \$450,000.
50. A large home surrounded by smaller homes would be concerned over the principle of regression.
51. Accrued depreciation is taken into account within the Income Approach.
52. The principle of conformity is concerned with a subject property being similar to its surrounding properties and uses.
53. The cost approach is the most reliable of the three approaches in appraising existing residential property.
54. Debt service is taken into consideration in the NOI when finding the value of a property.
55. To find the value of property within the capitalization approach, the NOI must be multiplied by the capitalization rate.
56. A Comparative Market Analysis is the same as an appraisal.

57. A Competitive Market Analysis can be used in place of an appraisal with a federally related loan.
58. The land on which a house was built is worth \$50,000. The house was constructed in 1986 at a cost of \$265,000 and was expected to last 50 years. Using straight-line depreciation, the property was worth \$96,600 in 2010.
59. The land on which a house was built is worth \$50,000. The house was constructed in 1986 at a cost of \$265,000 and was expected to last 50 years. Using straight-line depreciation, the property was worth \$187,800 in 2010.
60. A two-unit apartment building is being appraised. In this neighborhood, the accepted gross rent multiplier is 144. The annual income on the building is \$16,800 (both units rented). The monthly expenses are \$300. Based on the income approach, the estimated market value of the apartment building is \$201,600.
61. An apartment building has \$65,000 in potential gross annual income. The vacancy rate is estimated at 5%. Total operating expenses are \$29,000. The capitalization rate is 9%. Using the income approach the value of the building is \$392,367.
62. Slumlords, LLC owns an apartment building that generated \$60,000 in rental income, \$15,000 in expenses, and \$35,000 in debt service last year. Also, the property appreciated about \$10,000 last year. Last year's cash flow was \$15,000.
63. A property is being appraised by the cost approach. The appraiser estimates that the land is worth \$10,000 and the replacement cost of the improvements is \$75,000. Total depreciation from all causes is \$7,000. The value assigned is \$82,000.
64. An income property recently sold for \$400,000 to an investor who received a 9% return on his investment. An investor who wanted a 12% return on his money would pay \$300,000 for the same property.
65. A property has been depreciating 3% per year. If it is valued at \$70,000 today, it was worth \$10,000 ten years ago.

# 8

## Financing

### **Basic Concepts and Terminology**

### **The Paperwork**

### **Understanding Monthly Mortgage Payments**

### **Types of Loans**

### **The Lending Process**

### **Foreclosure and Short Sales**

### **The Money Supply**

### **Financing Laws and Rules**

Before the 1930s, few people could afford the upfront costs of buying a home. Buyers often needed a down payment of up to 80% of a property's purchase price and usually had only five to seven years to pay that loan back. These loans were often interest only and ended in a balloon payment where the entire amount borrowed would be due. (HowStuffWorks.com Contributors, 2021)

The Great Depression, due mostly to the impact of both 25% unemployment and housing prices dropping by approximately 33%, caused unbelievable stress to those who did have home mortgages. (Selgin, 2023)

“In 1932, roughly 273,000 people lost their homes, as compared to only 6,000 in 1926. Yet the bottom still hadn't been reached. By the time of Roosevelt's inauguration, with roughly a third of all U.S. mortgages in

default, and twice as many in arrears, lenders were foreclosing on 1,000 loans every day.” (Selgin, 2023)

Roosevelt’s New Deal package included the creation of the Federal Housing Authority or FHA in 1934, which protected lenders from defaulting borrowers and created several inventive reforms: the creation of a 15-year, fully amortized mortgage that would fully pay off the debt with interest; reducing the down payment to 20%; and requiring that borrowers could financially afford to make their payments. (HowStuffWorks.com Contributors, 2021) Surprisingly, these initial 90-year-old reforms are still considered by many borrowers to be the way lending works today. That’s why so many people still believe that they need 20% of the purchase price as a down payment to buy a home.

---

## Basic Concepts and Terminology

---

Most buyers acquire a loan to purchase real estate. While real estate licensees are not lenders, they do need to be familiar with the concepts and terminology involved in the lending process so they can communicate effectively with their clients and their clients’ lenders. In many states, the buyer’s basic loan information must be included in a purchase contract, therefore understanding these terms is pivotal.

The buyer and seller negotiate a **purchase price**. Unless the buyer is paying cash for the property, buyers (called borrowers in relation to lending) usually contribute a certain amount of money or **down payment** and finance the difference, known as the **loan amount**. Lenders don’t offer money for free; borrower’s pay back the loan amount plus **interest**, which is usually described as a percent of the loan amount.

The relationship between the amount of the mortgage loan and the value of the real estate pledged as collateral is call **LTV** or **loan to value**. The loan-to-value ratio is simply the amount of the loan divided by the value of the

property. For example, a loan of \$80,000 on a property valued at \$100,000 has an 80% loan to value ratio. The closer the loan value is to market value, the less the borrower is investing as a down payment and the riskier the loan is to the lender.

The difference between the value of the property and all of its liens is called **equity**. Equity increases as a function of paying down the loan balance as well as the natural **appreciation** the property experiences through market fluctuations. If a homeowner has a home with an appraised value of \$280,000 and a first mortgage of \$140,000 and a second mortgage of \$20,000, the owner has \$120,000 of equity.

**Hypothecation** is the formal term for pledging real property as security for that loan without losing possession of the property. If the borrower fails to pay the loan back, the real property can be taken by the lender through a process called **foreclosure**.

---

## The Paperwork

---

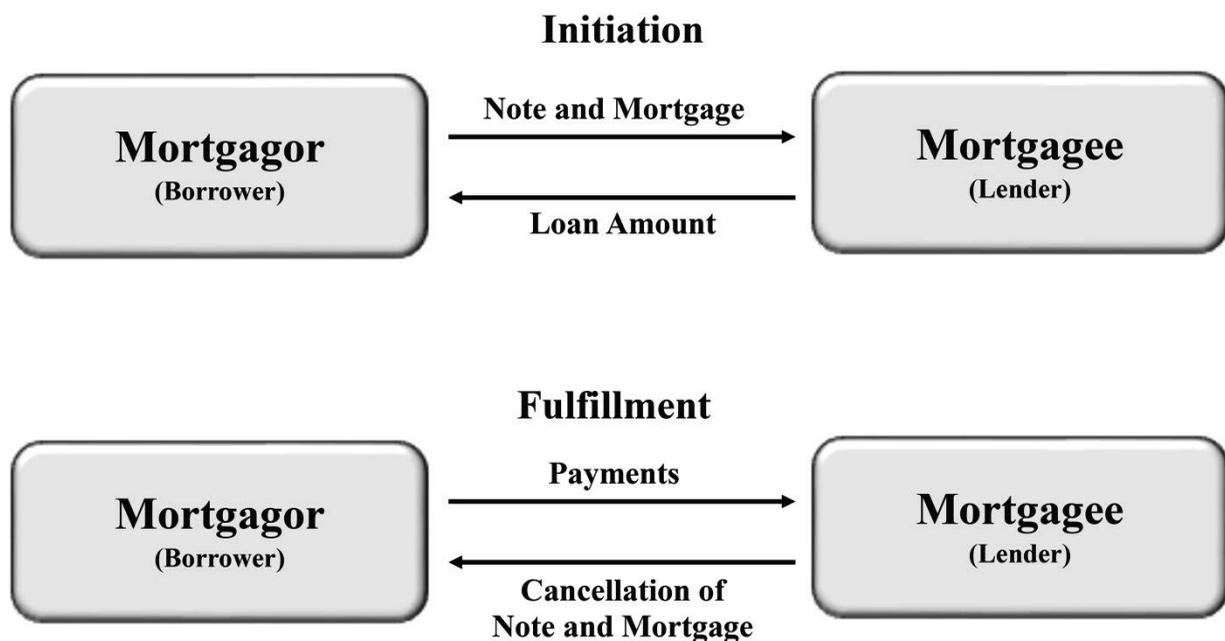
The legal document that pledges the property as collateral for the debt is either a **mortgage** or a **deed of trust**, depending on the state in which the loan originates. Recall the lien discussion in Chapter 5. In a lien theory state, the lender who puts a mortgage lien on a property holds equitable title while the homeowner has legal title. Title theory states give the lender legal title to the mortgaged property until the mortgagor satisfies the terms and obligations of the loan.

The term “mortgage” loosely translates into “death pledge” since, according to Sir Edward Cooke in 1644, it’s highly unlikely that a person who enters into a mortgage will be able to pay off the debt; the property pledged will be seized and therefore dead to the borrower. Another way of looking at it is that the mortgage terms are dead once the debt is paid off or the borrower stops making payments (The CE Shop Team, 2021).

A mortgage is a two-party document between the **mortgagor** (borrower) and the **mortgagee** (lender) that pledges the mortgagor's ownership interest in the property as collateral if the debt is not repaid. A deed of trust (also known as a **trust deed**) is a three-party document. It conveys title from the **trustor** (borrower) to a third-party **trustee** who holds title on behalf of the **beneficiary** (lender until the debt is repaid). A **public trustee** is either an elected or appointed county government position, however an attorney can act as a **private trustee**. Both a mortgage and a deed of trust are considered **security instruments** as they secure the real property as collateral.

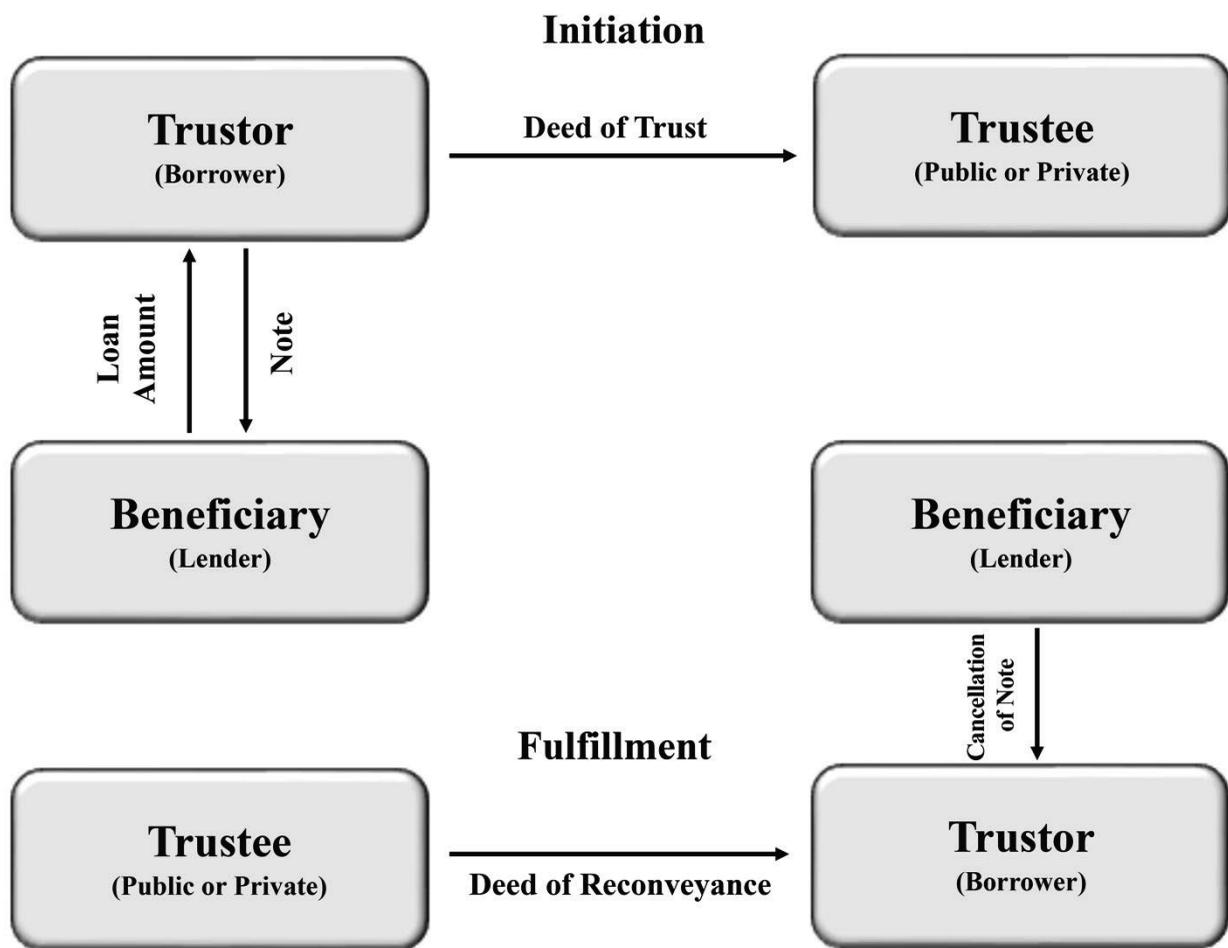
The second document involved when borrowing money is a **promissory note**. This legal instrument is signed by the borrower and states the debt amount, loan term, method and timing of repayment, **interest rate** and a **promise to pay**. It may repeat other provisions from a mortgage document or deed of trust and is a negotiable instrument assignable to a third party. The mortgagor signs a promissory note and mortgage, and in return gets money (the loan amount), which is paid back with interest over the **term** or life of the loan.

### Flow of a Mortgage Transaction



The trustor signs a deed of trust, which is given to the public or private trustee, and a promissory note, which is given to the beneficiary in exchange for money. The loan amount is paid back with interest to the beneficiary over the term or life of the loan.

### Flow of a Deed of Trust Transaction



Both documents may include **clauses** covering payment of the principal and interest, prepayment, late charges, escrows for taxes and insurance, liens, insurance requirements, occupancy and maintenance, lender’s rights, private mortgage insurance, inspection, and other conditions of performance. For example, with a mortgage, the **defeasance** clause states

that when the mortgagor defeats the loan (i.e., pays the loan balance and interest), the mortgagee executes a **satisfaction of mortgage** or a **release of mortgage**. With a deed of trust, the beneficiary or lender instructs the trustee to issue a **release deed** or a **reconveyance deed**. The **alienation clause**, also known as the **due on sale clause**, says that if the borrower sells the property, the lender has the choice of either declaring the entire debt due and payable or allowing the buyer to assume the loan.

---

## Understanding Monthly Mortgage Payments

---

A borrower must repay the amount of the loan, known as the **principal**, along with the interest charged by the bank for the use of their money. The **interest rate** then is the percentage of a loan amount that also must be paid to the lender and is usually calculated on an annual basis. Interest rates float with the open market and are negotiable with the lender originating the loan. The good news is that state laws limit the interest rates that lenders can charge; charging a rate of interest in excess of the maximum rate allowed by state law is called **usury** and is illegal.

## Math – Interest Calculations

Interest rate calculations are always calculated as an annual amount. The formula used is:

$$\text{Interest Rate} \times \text{Principal Amount} = \text{Annual Interest}$$

Using an acronym for this formula, we call it the IRP formula.

**I = Annual Interest Dollars**      **R = Rate of Interest**      **P = Principal**

Unless a problem states otherwise always use:

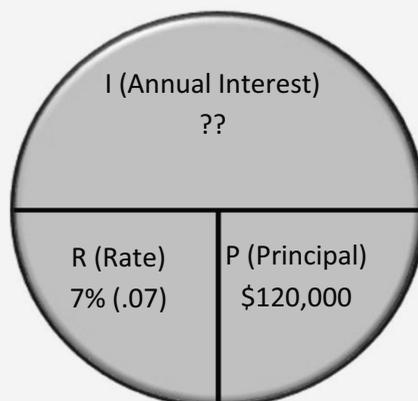
Simple interest (not compound)

30 days in every month

360 days in a year.

***Question 1 – Mark owes \$120,000 at 7% interest to First National Bank.  
How much money will he pay in interest in one year?***

**Step 1** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.



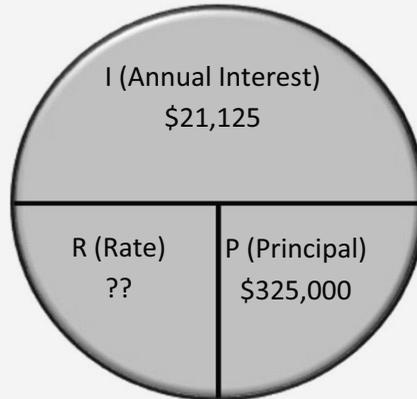
The formula instructs you to multiply the Rate by the Principal.

$$\$120,000 \times .07 = \$8,400 \text{ (Annual Interest).}$$

**Question 2 – A \$325,000 mortgage has quarterly interest payments of \$5,281.25. What is the interest rate?**

**Step 1** – Determine the annual interest by multiplying  $\$5,281.25 \times 4 = \$21,125$ .

**Step 2** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.



The formula instructs you to divide the Interest by the Principal.

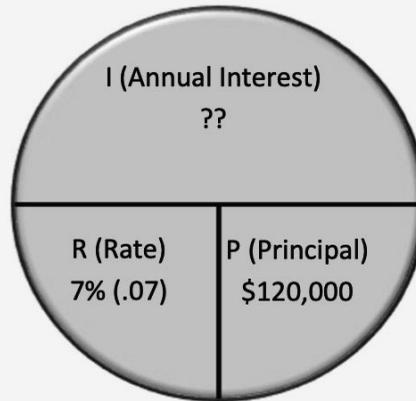
$\$21,125 \div 325,000 = .065$  or 6.5% (Interest Rate).

The monthly payment to the lender that describes the principal and interest is called the **P&I** payment. The majority of mortgage and deed-of-trust loans are **amortized** loans, which means the loan has been configured such that at the end of the loan's term all interest and the full amount of principal due will be paid. Also, the monthly payment amounts don't change over the life of an amortized loan. A portion of each payment is applied first to interest and then the remainder to principal.

The amount of interest due on a specific payment date is determined by calculating the total year's interest based on the unpaid loan balance and dividing that figure by the number of payments for each year. Using the example Question #1 above, Mark owes \$120,000 and agrees to pay 7% interest. Every year he owes \$8,400 in annual interest, therefore every month he owes \$700 in interest ( $\$8,400 \div 12$ ). If Mark's P&I payment is \$850, then \$150 of that payment pays down the principal balance (the \$120,000) while \$700 goes to the lender for interest on the loan. After that first payment, Mark's loan balance decreases by \$150 so he now owes \$119,300. This process can be repeated each month by determining the new calculated principal amount for each month. This process is essentially how an amortization is calculated.

**Question 3 – Mark owes \$120,000 at 7% interest to First National Bank. Mark’s monthly P & I payment is \$850. What will be his principal balance after his second monthly payment?**

**Step 1** – Draw the Circle Formula and place the information that you know in the appropriate parts of the formula.

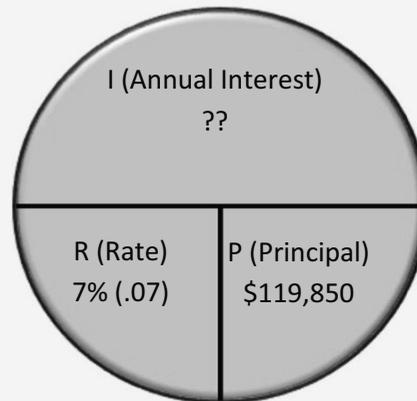


$$\$120,000 \times .07 = \$8,400 \text{ (Annual Interest)} \div 12 = \$700 \text{ interest in the first month}$$

**Step 2** – Marks monthly payment is \$850. The monthly interest is \$700.  
\$150 is applied to Principal in the first payment.

$$\$120,000 \text{ (Principal)} - \$150 \text{ (1<sup>st</sup> months Principal reduction)} = \$119,850$$

**Step 3** – Draw the Circle Formula again and place the updated Principal amount in the Principal section of the formula. The interest rate does not change.



$$\$119,850 \times .07 = \$8,389.50 \text{ (Annual Interest)} \div 12 = \$699.13 \text{ interest in the second month.}$$

**Step 4** – Marks monthly payment is \$850. The monthly interest is \$699.13.  
\$150.87 is applied to Principal in the second payment.

$$\$119,850 \text{ (Principal)} - \$150.87 \text{ (2nd months Principal reduction)} = \$119,699.13$$

**Marks principal balance after his second monthly payment is \$119,699.13**

A **mortgage factor chart** helps determine an amortized monthly payment when the annual interest rate and the principal amount are known depending on the loan term (5 year, 10 year, 15 year, 20 year, 30 year, etc.). The factor is multiplied by the number of thousands (and fractions thereof) of the amount being borrowed. The following chart shows the monthly payment.

<b>MONTHLY PAYMENT FACTORS (PER \$1,000)</b>		
<b>Rate</b>	<b>15 Years</b>	<b>30 Years</b>
7.00%	\$8.99	\$6.65
7.25%	9.13	6.82
7.50%	9.27	6.99
7.75%	9.41	7.16
8.00%	9.56	7.34
8.25%	9.70	7.51
8.50%	9.85	7.69
8.75%	10.00	7.87
9.00%	10.15	8.05
9.25%	10.30	8.23
9.50%	10.45	8.41
9.75%	10.60	8.60
10.00%	10.75	8.78
10.25%	10.90	8.97
10.50%	11.06	9.15
10.75%	11.21	9.34
11.00%	11.37	9.53
11.25%	11.53	9.72
11.50%	11.69	9.91
11.75%	11.85	10.10
12.00%	12.01	10.29
12.25%	12.17	10.48
12.50%	12.33	10.68

Example: What is the monthly payment on a \$60,000 loan at 9% for 30 years?

Solution: Refer to the monthly payment factors chart. Move down the Rate column to 9%. Then move to the right to the column headed 30 Years to find the payment on a \$1,000 loan (\$8.05). To find the monthly payment on the \$60,000 loan, multiply the \$8.05 x 60 ( $\$60,000 \div 1,000$ ) = \$483.

The \$483 monthly payment is for the principal and interest. In addition, the lender also collects 1/12 of the property taxes and 1/12 of the homeowner's

insurance bill with each payment and places those funds in **escrow** or **impound accounts**. These accounts are created by the lender to set aside funds collected from the borrower for a property's future bills. The payment that also includes the escrow payments for taxes and insurance is called **PITI** (Principal, Interest, Taxes and Insurance).

While many loan types allow for a down payment less than 20%, borrowers who do so are considered at higher risk of defaulting because they are not as monetarily invested in the purchase. To offset that risk, many lenders will require those borrowers to also pay **PMI** or **Private Mortgage Insurance**. This insurance policy protects the lender against loss of that portion of a mortgage that exceeds the acceptable loan-to-value ratio. The borrower would be charged the market rate of interest plus reasonable mortgage insurance premium costs. PMI insurance premiums are made a part of the borrower's monthly payment. As property values rise and the loan-to-value ratio becomes 80% or less, the borrower can request that the PMI be dropped.

### ***Reducing Loan Interest Rates by Paying Points***

While borrowers pay the interest rate offered by a lender based on the current cost of money, their credit score, and other factors, they can reduce their interest rate by paying some of the interest up front. This pre-paid interest is used to buy down or lower the interest rate and is calculated in **points** or a percentage of a loan amount.

**A POINT = 1% of the Loan Amount  
(1 point on a \$100,000 loan is \$1,000)**

**1 Point reduces the interest rate by 1/8%  
(2 pts = .25%, 4 pts = .50%, 6 pts = .75%, 8 pts = 1%)**

Paying 1% of the loan amount up front does NOT reduce the loan interest rate by an equal amount. Each point generally reduces the interest rate by 1/8%. Restated, it takes 8 points to reduce an interest rate by a full 1%. Because they are paid up front, points are said to **increase the lender's yield** (profit) on a loan. Therefore, a lender would need to charge 8 points to raise their yield by 1%.

If a buyer wanted to buy down his interest rate from 6.5% to 6%, he would need to pay 4 points since 8 points equals a full 1% decrease (.5 x 8). On a loan of \$300,000, that would mean paying \$12,000 up front in addition to all other loan closing costs. Obviously, this would have a big impact over the life of a 30-year loan, but if the borrower only planned to live in the house for five years before moving again, she may not recoup that investment.

From the lender's perspective, if the lender needed to earn 6.75% on a loan offered at 6.5%, the number of points necessary would be calculated by first identifying the difference between the offered interest rate and the lender's desired yield:  $6.75\% - 6.5\% = .25\%$ . Next, since it's 8 points to a full 1% drop, multiply  $8 \times .25 = 2$  points. On a loan of \$100,000, the 2 points would cost the borrower  $100,000 \times .02 = \$2,000$  in pre-paid interest.

---

## Types of Loans

---

### CONVENTIONAL

**Conventional** loans are permanent, long-term financing vehicles that are not FHA or VA. Market rates determine the loan's interest rate. Qualification for these loans is based solely on the borrower's ability to pay. The lender may still require PMI as well as escrows for taxes and insurance. These loans are considered risky to the lender; therefore, interest rates and qualification requirements may be stricter. Conventional loans are available through banks and savings and loans, credit unions, life insurance companies, mortgage bankers, mortgage brokers and even private individuals.

## FHA

As mentioned at the beginning of this chapter, **FHA** or the Federal Housing Authority (a division of the Department of Housing and Urban Development) *insures* approved lenders against loss on loans made on new or existing one-to-four-unit family housing; neither FHA nor HUD originates these loans. The borrower must meet certain FHA qualifications and the property must meet FHA standards. FHA loans allow borrowers to purchase a property with as little as a 3.5% down payment. The borrower finances an up-front FHA **mortgage insurance premium** or **MIP** of 1.75%, which may be partially refundable and can be financed. The borrower also pays a monthly insurance premium based on 1.25% of the mortgage for the life of the loan, which cannot be financed. Unfortunately, this mortgage insurance does not go away when the property has over 20% equity.

FHA reimburses the lender for losses due to borrower default. This can also include reimbursement for costs of foreclosure. The property must be appraised by an FHA-approved appraiser. Other important characteristics of FHA loans are that FHA does not allow a pre-payment penalty, FHA mortgages are assumable with qualification and the lender may charge discount points and a 1% origination fee.

## VA

Since 1944, the Department of Veterans Affairs (**VA**) has *guaranteed* home loans for entitled veterans or an un-remarried surviving spouse (with required down payment). Additionally, National Guard members and reservists with at least six years of service are eligible for VA-guaranteed loans.

The interest rate of the loan is set by the lender; VA doesn't originate these loans, they guarantee a portion of the loan to protect the lender against loss if the borrower defaults. VA loans can be up to 100% loan to value, so those eligible for these loans often pay no down payment. VA sets no limitation on how much a veteran can borrow to finance a home; however, VA will only guarantee a maximum of 25% of the county loan limit for loans over \$144,000. If the selling price is higher than that amount, the lender may require a down payment.

VA does not charge PMI, but the borrower may have to pay up to a 3.3% funding fee based on:

- Usage
- The veteran's military category.
- Whether the veteran is a first-time or a subsequent loan user.
- Whether the veteran makes a down payment.

The property must be appraised by a VA-approved appraiser who must complete a Certificate of Reasonable Value (CRV). The VA's guarantee is based on either the amount of the CRV or the selling price, whichever is less.

A VA loan may be assumed by a veteran, qualified non-veteran, or by a qualified un-remarried surviving spouse. VA does not allow a prepayment penalty.

A variety of loan programs have been created to build or improve housing in rural areas. US Department of Agriculture (**USDA**) offers loans, grants and guarantees for single and multi-family housing to help low- and moderate-income rural Americans buy safe, affordable housing in rural areas. They also offer loans and grants to help rural homeowners make health and safety repairs to their homes.

## **USDA**

USDA's Multi-Family Housing Program offers loans to provide affordable rental housing for very-low, low and moderate-income residents, the elderly, and persons with disabilities. USDA also offers rental assistance to help eligible rural residents with their monthly rental costs.

Down payment assistance is available through government programs at the federal, state and local level, as well as through charitable organizations. Government grants are available to first-time home buyers as long as the family income meets the stipulated minimum, which varies according to the median income for the area as well as the number of dependents.

Government down payment assistance programs are generally interest free and do not require a monthly payment. Some of these grants take the form of a second mortgage that does not have to be repaid until the house is sold. In many of the programs, the grant will not have to be repaid if the home is owned for a specified number of years.

As mentioned earlier, conventional, VA, FHA, and USDA loans are amortized to provide for gradual repayment of principal and interest over the term of the loan. The borrower's periodic payments to the lender include a portion for interest and principal. The principal balance of the loan at the end of a fully amortized loan will be \$0.

In a **partially amortized** loan, the payments are not enough to repay the debt. These lower monthly payments result in a remaining principal balance at the end of the loan term; this remaining balance is paid off in one lump sum often referred to as a **balloon payment**. A **negative amortized** (sometimes called reverse amortization) loan causes the loan balance to increase over the loan. The payment will not cover the interest owed for the period so the lender adds the amount of unpaid interest to the borrower's loan balance. Examples of negative amortized loans include graduated payment loans and some Adjustable-Rate Mortgages.

Here are some additional types of loans:

1. **Adjustable-Rate Mortgage (ARMs)** – Considered variable interest rate loans, ARMs begin with a fixed interest rate for a specified number of years and then allow the lender to change the interest rate at determined intervals and by a specific amount based of an agreed upon benchmark. Federal regulations place limits on incremental interest rate increases and on the total amount by which the rate may be increased over the loan term.
2. **Interest Only Loans** – Also known as straight loans, payments made over the loan term apply only to interest owed, not to principal. At the end of the term, the full balance must be paid off in a lump sum. Payments may be smaller than a fully amortized loan because no amount is being applied to principal reduction.
3. **Buydown Loan** - Entails prepayment of interest on a loan, which effectively lowers the interest rate and the borrower's periodic payments.
4. **Wraparound-** The seller receives a junior mortgage from the buyer and uses the buyer's payments to make the original first mortgage's payments. This enables the buyer to obtain financing with a minimum cash investment. A wraparound may allow the seller to profit from any difference between a lower interest rate on the senior loan and a

higher interest rate on the wraparound loan. These are only possible if the senior mortgage allows it (i.e. there's no alienation clause).

5. **Home Equity Loan/Home Equity Line of Credit**– This loan is used by a homeowner to borrow against the accrued equity in a home, often to pay for upgrades and repairs.
6. **Package Loan** - finances the purchase of real estate and personal property, like a furnished condo.
7. **Construction Loan** - Finances construction of improvements by paying out in installments linked to stages of the construction process. The loan may be interest-only. The borrower makes periodic payments based on the amount that has been disbursed. Construction loans are considered short-term, high risk, expensive financing. The borrower is expected to find permanent “take-out” financing elsewhere to pay off the temporary loan when construction is complete.
8. **Bridge Loan** - Also known as a gap loan, these are used to cover the gap between construction financing and long-term financing. They are considered very-short-term financing.
9. **Permanent (take-out) Loan** - A long-term loan that “takes-out” a construction or short-term lender. The long-term lender pays off the balance on the construction loan when the project is completed and provides the borrower with a longer term and less expensive loan such as a conventional, 30-year fixed rate loan.
10. **Reverse Annuity** - A homeowner pledges the equity in their home as security for a loan that is paid out in regular monthly amounts over its term to the homeowner. The homeowner, in effect, converts the equity into cash without losing ownership and possession. Commonly advertised to seniors who need monthly income.
11. **Seller Financing** –Also known as **Purchase Money Mortgages**, this is a loan made by the seller to the property buyer for all or part of the purchase price. Similar to those funded by a lender, the borrower gives a mortgage and a promissory note to the seller, who is said to “take-back” or to “carry paper” on the property.
12. **Contract for Deed/Land Contract** –An **Installment** sale where the seller (also known as the vendor) finances the buyer (vendee) and retains legal title until the contract terms are fully performed. The

buyer receives the right to possess the property and equitable title while making payments to the seller during the term. In effect, the buyer gets the right to occupy the property while making principal and interest payments over a number of years but doesn't receive the deed until the entire purchase price has been paid.

13. **Blanket Mortgage** –Usually used by developers, this loan covers more than one property or lot. It generally includes a partial release clause so as subdivided lots are sold, they are removed from the blanket mortgage and the buyer can obtain his or her own financing.

---

## The Lending Process

---

Applying for a loan starts when a borrower completes a loan application and submits it for review by the loan officer. The application is commonly completed on the “Uniform Residential Loan Application” form provided by Fannie Mae. Many lenders offer an online application process.

Borrowers provide information about the property and themselves, including supporting documentation such as their age, employment history, assets, monthly income and expenses, and a credit report. Once under contract, the lender will need additional information about the property such as an appraisal report and a copy of the purchase contract. Federal law requires lenders to accept all loan applications and give written notice concerning whether the application has been approved or denied; denied applications must include specific reasons.

The lender must rely on eight types of information to determine that the borrower can repay the loan:

1. Current income or assets (excluding the value of the mortgaged property)
2. Current employment status

3. Credit history
4. Monthly payment for the mortgage
5. Monthly payments being made on other loans on the same property
6. Monthly payments for other mortgage-related expenses
7. Other debts
8. Monthly debt payments compared to monthly income (debt-to-income ratio)

A lender assesses risks by examining, or qualifying, both the borrower and property. In qualifying a borrower, an underwriter weighs the ability of the borrower to repay the loan. Borrower's income, cash resources, creditworthiness, net worth, employment stability and debt load must meet the lender's standards.

The **income ratio**, or housing expense ratio, establishes borrowing capacity by limiting the percent of gross income a borrower may spend on housing costs (PITI and possible HOA fees, utilities and MIP). The income ratio is calculated by dividing monthly housing expenses by monthly gross income. *Most conventional lenders require this ratio to be no greater than 25% – 28%. FHA loans have a ratio of 31%. VA loans do not utilize this qualifying ratio.* So, a borrower with \$4,000 monthly gross income qualifying for a conventional loan with a 28% income ratio could have a total housing expense of \$1,120 per month.

The **debt ratio** considers all of the monthly obligations of the income ratio plus any additional monthly payments the borrower must make for other debts. Debt ratio is determined by adding the borrower's monthly housing expense plus monthly debt obligations and dividing that by his or her monthly gross income. *Most conventional lenders require this ratio be no greater than 36%. FHA loans can have a ratio no greater than 43%. VA loans will utilize 41% and a variable "residual income" calculation.* The same borrower with \$4,000 monthly gross income qualifying for a conventional loan with a 36% debt ratio could have a total housing and debt expense of \$1,440 per month.

Lenders also evaluate an applicant's income stability. They may look at:

- How long the applicant has been employed at his or her present job.
- How frequently and for what reasons the applicant has changed jobs in the past.
- How likely secondary income such as bonuses and overtime is to continue, and;
- How education level, training and skills, age, and type of occupation may affect the continuation of the present income level in the future.

A lender will verify that a borrower has the cash resources to make the required down payment. Gift money may require that the donor provide a "gift letter" attesting that the money does not need to be repaid.

A lender must obtain a written credit report on any applicant who submits a completed loan application. The credit report will contain the applicant's history regarding:

- Outstanding debts
- Payment behavior (timeliness, collection problems)
- Legal information of public record (judgments, lawsuits, etc.)
- Bankruptcies, divorces, foreclosures, short sales, repossessions, and
- Problems with payment behavior that are likely to cause a lender to deny the application.

If a lender denies a loan on the basis of a credit report, the lender must disclose in writing that the applicant is entitled to a statement of reason from any creditor responsible for the negative report. Lenders also utilize **credit scoring** to assign a numerical value to an applicant's credit. The credit score, sometimes referred to as a **FICO score**, is a statistical prediction of a borrower's likelihood of defaulting on a loan.

The Consumer Financial Protection Bureau (CFPB) requires lenders to use two specific forms to disclose settlement costs to the buyer. A lender must provide a **Loan Estimate** within three days of receiving the loan application and allow the buyer to see the **Closing Disclosure** three days before loan consummation. These documents include settlement charges, title charges, recording and transfer fees, required reserve deposits, tax and homeowner's insurance impound account deposits and other closing costs.

# FICUS BANK

4321 Random Boulevard • Somcity, ST 12340

Save this Loan Estimate to compare with your Closing Disclosure.

## Loan Estimate

**DATE ISSUED** 2/15/2013  
**APPLICANTS** Michael Jones and Mary Stone  
 123 Anywhere Street  
 Anytown, ST 12345  
**PROPERTY** 456 Somewhere Avenue  
 Anytown, ST 12345  
**SALE PRICE** \$180,000

**LOAN TERM** 30 years  
**PURPOSE** Purchase  
**PRODUCT** Fixed Rate  
**LOAN TYPE**  Conventional  FHA  VA  \_\_\_\_\_  
**LOAN ID #** 123456789  
**RATE LOCK**  NO  YES, until 4/16/2013 at 5:00 p.m. EDT  
*Before closing, your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on 3/4/2013 at 5:00 p.m. EDT*

Loan Terms	Can this amount increase after closing?	
<b>Loan Amount</b>	\$162,000	<b>NO</b>
<b>Interest Rate</b>	3.875%	<b>NO</b>
<b>Monthly Principal &amp; Interest</b> <i>See Projected Payments below for your Estimated Total Monthly Payment</i>	\$761.78	<b>NO</b>
<b>Does the loan have these features?</b>		
<b>Prepayment Penalty</b>	<b>YES</b> • As high as \$3,240 if you pay off the loan during the first 2 years	
<b>Balloon Payment</b>	<b>NO</b>	

Projected Payments		
Payment Calculation	Years 1-7	Years 8-30
Principal & Interest	\$761.78	\$761.78
Mortgage Insurance	+ 82	+ —
Estimated Escrow <i>Amount can increase over time</i>	+ 206	+ 206
<b>Estimated Total Monthly Payment</b>	<b>\$1,050</b>	<b>\$968</b>
<b>Estimated Taxes, Insurance &amp; Assessments</b> <i>Amount can increase over time</i>	\$206 a month	<b>This estimate includes</b> <input checked="" type="checkbox"/> Property Taxes <input checked="" type="checkbox"/> Homeowner's Insurance <input type="checkbox"/> Other: <i>See Section G on page 2 for escrowed property costs. You must pay for other property costs separately.</i>
		<b>In escrow?</b> <b>YES</b> <b>YES</b>

Costs at Closing	
<b>Estimated Closing Costs</b>	\$8,054 Includes \$5,672 in Loan Costs + \$2,382 in Other Costs – \$0 in Lender Credits. <i>See page 2 for details.</i>
<b>Estimated Cash to Close</b>	\$16,054 Includes Closing Costs. <i>See Calculating Cash to Close on page 2 for details.</i>

Visit [www.consumerfinance.gov/mortgage-estimate](http://www.consumerfinance.gov/mortgage-estimate) for general information and tools.

LOAN ESTIMATE

PAGE 1 OF 3 • LOAN ID # 123456789

## Closing Cost Details

### Loan Costs

<b>A. Origination Charges</b>	<b>\$1,802</b>
.25 % of Loan Amount (Points)	\$405
Application Fee	\$300
Underwriting Fee	\$1,097

<b>B. Services You Cannot Shop For</b>	<b>\$672</b>
Appraisal Fee	\$405
Credit Report Fee	\$30
Flood Determination Fee	\$20
Flood Monitoring Fee	\$32
Tax Monitoring Fee	\$75
Tax Status Research Fee	\$110

<b>C. Services You Can Shop For</b>	<b>\$3,198</b>
Pest Inspection Fee	\$135
Survey Fee	\$65
Title – Insurance Binder	\$700
Title – Lender’s Title Policy	\$535
Title – Settlement Agent Fee	\$502
Title – Title Search	\$1,261

<b>D. TOTAL LOAN COSTS (A + B + C)</b>	<b>\$5,672</b>
--	----------------

### Other Costs

<b>E. Taxes and Other Government Fees</b>	<b>\$85</b>
Recording Fees and Other Taxes	\$85
Transfer Taxes	

<b>F. Prepaids</b>	<b>\$867</b>
Homeowner’s Insurance Premium ( 6 months)	\$605
Mortgage Insurance Premium ( months)	
Prepaid Interest ( \$17.44 per day for 15 days @ 3.875%)	\$262
Property Taxes ( months)	

<b>G. Initial Escrow Payment at Closing</b>	<b>\$413</b>
Homeowner’s Insurance \$100.83 per month for 2 mo.	\$202
Mortgage Insurance per month for mo.	
Property Taxes \$105.30 per month for 2 mo.	\$211

<b>H. Other</b>	<b>\$1,017</b>
Title – Owner’s Title Policy (optional)	\$1,017

<b>I. TOTAL OTHER COSTS (E + F + G + H)</b>	<b>\$2,382</b>
---	----------------

<b>J. TOTAL CLOSING COSTS</b>	<b>\$8,054</b>
D + I	\$8,054
Lender Credits	

### Calculating Cash to Close

Total Closing Costs (J)	\$8,054
Closing Costs Financed (Paid from your Loan Amount)	\$0
Down Payment/Funds from Borrower	\$18,000
Deposit	– \$10,000
Funds for Borrower	\$0
Seller Credits	\$0
Adjustments and Other Credits	\$0
<b>Estimated Cash to Close</b>	<b>\$16,054</b>

## Additional Information About This Loan

**LENDER** Ficus Bank  
**NMLS/\_\_\_ LICENSE ID**  
**LOAN OFFICER** Joe Smith  
**NMLS/\_\_\_ LICENSE ID** 12345  
**EMAIL** joesmith@ficusbank.com  
**PHONE** 123-456-7890

**MORTGAGE BROKER**  
**NMLS/\_\_\_ LICENSE ID**  
**LOAN OFFICER**  
**NMLS/\_\_\_ LICENSE ID**  
**EMAIL**  
**PHONE**

Comparisons	Use these measures to compare this loan with other loans.	
<b>In 5 Years</b>	\$56,582	Total you will have paid in principal, interest, mortgage insurance, and loan costs.
	\$15,773	Principal you will have paid off.
<b>Annual Percentage Rate (APR)</b>	4.274%	Your costs over the loan term expressed as a rate. This is not your interest rate.
<b>Total Interest Percentage (TIP)</b>	69.45%	The total amount of interest that you will pay over the loan term as a percentage of your loan amount.

Other Considerations	
<b>Appraisal</b>	We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost.
<b>Assumption</b>	If you sell or transfer this property to another person, we <input type="checkbox"/> will allow, under certain conditions, this person to assume this loan on the original terms. <input checked="" type="checkbox"/> will not allow assumption of this loan on the original terms.
<b>Homeowner's Insurance</b>	This loan requires homeowner's insurance on the property, which you may obtain from a company of your choice that we find acceptable.
<b>Late Payment</b>	If your payment is more than 15 days late, we will charge a late fee of 5% of the monthly principal and interest payment.
<b>Refinance</b>	Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.
<b>Servicing</b>	We intend <input type="checkbox"/> to service your loan. If so, you will make your payments to us. <input checked="" type="checkbox"/> to transfer servicing of your loan.

**Confirm Receipt**  
 By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

\_\_\_\_\_  
 Applicant Signature Date Co-Applicant Signature Date

The costs in the Closing Disclosure must match those in the Loan Estimate within certain tolerances. Some charges may be more than the Loan Disclosure such as insurance premiums, escrow balances, impounds, etc. as long as the initial amounts on the Loan Disclosure were figured in good faith.

After all the necessary documents are collected and the application is complete, the loan file is sent to underwriting for review. An underwriter evaluates the loan's risks as well as the borrower's qualifications to determine the borrower's ability to repay the loan and how strong the property is as collateral. The underwriter may have additional conditions that the borrower must meet or documents that must be provided before they issue loan commitment, which is a written agreement to provide the specified loan.

While it is certainly true that there are costs associated with getting a mortgage loan, some of these expenses may be **tax deductible**, such some loan origination fees, interest paid on mortgages on first and second homes, real estate taxes (excluding penalties for late payment), discount points on loans and prepayment penalties on loans.

---

## Foreclosure and Short Sales

---

When a borrower defaults on a mortgage – doesn't make payments as promised – the mortgagee's legal recourse is **judicial foreclosure**, where the lender sues the borrower in court, obtaining a judgment and a court order to sell. The property is sold at public sale to the highest bidder. The mortgage generally must include a power-of-sale clause, through which the borrower has pre-authorized the sale of the property to pay of the balance if he or she is in default. Additionally, an acceleration clause allows the lender to call the note due before the scheduled end of the term.

The main benefit of a deed of trust compared to a mortgage is that if the borrower defaults, the third-party public trustee is called upon to foreclose

and sell the property for the lender (beneficiary). Because this occurs outside of the court system, this **non-judicial foreclosure** requires that a notice of default must be recorded, and a public sale advertised in the newspaper. The property is sold at a public sale to the highest bidder.

The foreclosure process includes two redemption periods during which the borrower can regain interest in the property. In the **equitable redemption** process prior to the public sale the borrower can pay the back payments plus fees and penalties and reinstate the mortgage. In some states after the public sale a **statutory redemption** period allows the borrower an opportunity to pay off the entire loan balance plus fees and penalties and then keep the property. In those states, the winning bidder receives a Certificate of Purchase, not a deed, until after the statutory redemption period. If the defaulting homeowner cannot redeem during this statutory period, the winning bidder exchanges the Certificate of Purchase for a Treasurer's Deed and can take possession of the property at that time.

In a **strict foreclosure**, the court may award title to the lender. With a **deed in lieu of foreclosure**, the borrower gives the lender a deed to the property. If the property is sold and the proceeds are insufficient to pay the loan and foreclosure costs, the difference is a **deficiency judgement**. The lender usually can sue the original borrower for the difference.

FORECLOSURE PROCESSES		
JUDICIAL	NON-JUDICIAL	STRICT
Default	Default	Default
Acceleration of the Note	Acceleration of the Note	Acceleration of the Note
Foreclosure Suit		Foreclosure Suit
Notice	Notice	
Public Sale	Public Sale	Title to Lender
Deficiency Judgment	Deficiency Suit	Deficiency Suit

If the borrower is making payments but needs to sell the property and owes more on it than it's worth, a **short sale** may be possible. This procedure prevents foreclosure, which is a costly process for the bank. The owner gets the property under contract with a buyer but for a market value less than the outstanding loan balance. The contract is contingent on the lender's approval; however, this does not relieve the lienholder of their entire monetary obligation unless so agreed to by the lender. The lender could still sue for a deficiency judgment.

---

## The Money Supply

---

Believe it or not, money is in limited supply. The Federal Reserve System, also known as "the Fed," controls how much money is available and how much it costs institutions to borrow money to fund many things, including consumer loans. It does this by changing the discount rate or the interest rate it charges member institutions to borrow money from Federal Reserve System's central banks. Understandably, if the Fed raises the discount rate, making it more expensive for banks to borrow money, some banks will not borrow money to make consumer loans and the supply "tightens."

The financial institutions that make loans directly to consumers are said to belong to the **primary mortgage market**. Primary mortgage market lenders include:

- savings and loans
- commercial banks
- mutual savings banks
- life insurance companies
- mortgage bankers
- credit unions

As a point of clarification, a mortgage banker is a loan officer who presents his or her bank's loan products and facilitates the loan process. Mortgage

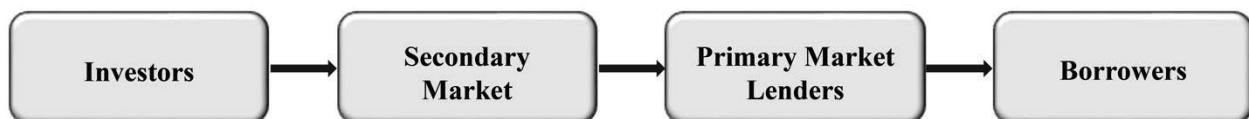
brokers, on the other hand, help borrowers understand and choose a loan product from the various offerings of numerous lenders/investors.

The primary lender assumes the initial risk of the long-term investment in the mortgage loan. Many lenders originate loans for the purpose of retaining the investments in their own loan portfolio. These loans are referred to as portfolio loans, and lenders originating loans for their own portfolio are called portfolio lenders. Portfolio lenders may vary underwriting criteria and hold independent standards for down payment requirements and the condition of the collateral. When they hold their own loans and collect payments, they are said to **service** the loan until it is paid off.

Lenders, investors and government agencies that buy loans already originated by someone else or originate loans indirectly through someone else belong to the **secondary mortgage market**. These organizations include:

- Federal National Mortgage Association (FNMA, or Fannie Mae)
- Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac)
- Government National Mortgage Association (GNMA, or Ginnie Mae)
- investment firms that assemble loans into packages and sell securities based on the pooled mortgages
- life insurance companies
- pension funds
- primary market institutions who also invest as secondary lenders

Secondary mortgage market organizations buy pools of mortgages from primary lenders and sell securities backed by these pooled mortgages to investors.



The secondary market only buys loans that meet established requirements for quality of collateral, borrower and documentation. Since many primary lenders intend to sell their loans to the secondary market, the qualification standards of the secondary market limit and effectively regulate the kind of loans the primary lender will originate.

The primary players to concentrate on are Federal National Mortgage Association (FNMA, or Fannie Mae), Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac) and Government National Mortgage Association (GNMA, or Ginnie Mae).

**Federal National Mortgage Association (FNMA)** is a government-sponsored enterprise, originally organized as a privately-owned corporation. As a secondary market player, it buys conventional, FHA-backed and VA-backed loans; gives banks mortgage-backed securities in exchange for blocks of mortgages; and offers lenders firm loan purchase commitments, provided they conform to Fannie Mae's lending standards. FNMA also sells bonds and mortgage-backed securities and guarantees payment of interest and principal on mortgage-backed securities.

**Government National Mortgage Association (GNMA)** is a division of the Department of Housing and Urban Development. Its purpose is to administer special assistance programs and to help Fannie Mae in its secondary market activities. Specifically, GNMA guarantees payment on FNMA high-risk, low-yield mortgages and absorbs the difference in yield between the mortgages and market rates. It also guarantees privately generated securities backed by pools of VA and FHA-guaranteed loans.

**Federal Home Loan Mortgage Corporation (FHLMC)** is a government-sponsored enterprise that buys mortgages and pools them, selling bonds backed by the mortgages in the open market. Freddie Mac guarantees performance on FHLMC mortgages.

---

## Financing Laws and Rules

---

Truth in Lending Act (**TILA**) /**Regulation Z** requires that costs in credit transactions be disclosed to borrowers. Regulation Z applies to loans to individuals for all real estate credit transactions for personal, family and household purposes, regardless of the amount involved.

Regulation Z requires that all finance charges as well as the true annual percentage rate (APR) must be disclosed to the customer before the transaction is completed. This APR is expressed as a percentage and includes the note's interest rate, loan fees, points, service charges, finder's fees, and property and credit insurance. The APR allows a consumer to compare different loan offerings in a fair and complete manner. For example, let's say Lender 1 is offering a loan at 6% interest that would cost the borrower 1% origination fee while Lender 2 is offering a loan at 6.5% interest with no origination fee. The borrower may not understand how to determine which loan is best. Because lenders also have to disclose the APR, which takes the loan interest rate and fees into consideration, now the borrower can see which loan will cost more.

A "cooling off" period is required when liens such as a refinance or home equity loan will be placed on a principal residence. The borrower has the right to rescind the transaction up to midnight of the third business day following the transaction or until the delivery of the disclosure statement, whichever is later. The right to rescind does not apply to loans that finance the purchase or initial construction of a house.

Regulation Z also includes advertising requirements. Specific credit terms (called trigger terms) may not be advertised unless the ad includes full disclosure of these terms:

- The down payment
- Repayment terms
- The Annual Percentage Rate
- Whether the rate can be increased after the consummation of the loan

Penalties for non-compliance of Regulation Z include imprisonment of up to a year and/or a fine of \$5,000. Those who violate an administration order enforcing Regulation Z pay \$10,000 for each day the violation continues. Engaging in unfair or deceptive trade practices may result in a fine up to \$10,000.

The Real Estate Settlement Procedures Act or **RESPA**, which was created to ensure that buyers understand settlement costs, applies to purchases of residential real estate (one to four-family homes) financed by "federally related" first mortgage loans such as VA and FHA backed loans. The Act prohibits lenders from paying **kickbacks** and unearned fees to parties who

may have helped the lender obtain the borrower's business (i.e. a referral from a real estate professional, etc.). RESPA requires that lenders provide a loan applicant with a loan information booklet (Settlement Costs and You) and the Loan Estimate and Closing Disclosure documents previously discussed.

As a review, the federal **Equal Credit Opportunity Act (ECOA)** also prohibits discrimination against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (if the applicant is of legal age), or dependency on public assistance. It requires that all rejected credit applicants be informed, in writing, of the reasons for credit denial within 30 days.

**Mortgage fraud** perpetrated through acts such as the use of identity theft and false documents, and the occasional willing or unwilling assistance of professionals in real estate, is investigated by the FBI and is punishable by up to 30 years in prison, a \$1 million fine, or both. Examples could include fictitious or stolen identity, or inflated appraisals where an appraiser works in collusion with a borrower or a lender to provide a misleading appraisal report that inaccurately states an inflated property value.

**Predatory lending** is defined as any practice in which lenders try to coerce borrowers into agreeing to loans that are unaffordable and violate industry standards. For example:

- Offering only loans with interest rates that the borrower cannot afford and including unnecessary fees or charges.
- Pushing the consumer into a product that is not a “qualified mortgage” that meets the borrower’s ability-to-repay requirements.
- Moving a borrower from one loan to another near the end of the payment schedule to extend interest payments.
- Adding to the overall cost of the loan by having the borrower refinance before the end of the current payment schedule.
- Requiring more insurance on a property than is necessary.



# Chapter 8 Key Point Review

---

## 1. Basic Concepts and Terminology

- a. Purchase Price – the amount a property is purchased for.
- b. Down Payment – the amount paid that is the difference between the purchase price and the loan amount.
- c. Loan Amount – the amount financed.
- d. Interest – the charge for financing. A percentage of the loan amount.
- e. Loan to Value (LTV) – the amount of the loan divided by the value of the property.
- f. Equity – the difference between the value of the property and all of its liens.
- g. Appreciation – the property increasing in value through market changes.
- h. Hypothecation – pledging property as security for the loan without losing possession of the property.

## 2. The Paperwork

- a. Mortgage or Deed of Trust – document that pledges the property as collateral for the debt.
  - i. A Mortgage is a two-part document between the mortgagor (borrower) and the mortgagee (lender).
  - ii. A Deed of Trust is a three-party document.
    - 1. Conveys title from the trustor (borrower) to a third-party Trustee who holds title on behalf of the beneficiary (lender.)
    - 2. Public Trustee – either an elected or appointed county government position.
    - 3. Private Trustee – could be an attorney.
    - 4. Trustor signs a deed of trust, which is given to the public or private trustee.
- b. Promissory Note
  - i. Signed by the borrower.
  - ii. States the debt amount, loan term, method and timing of repayment, interest rate, and a promise to pay.

iii. Assignable.

c. Clauses

- i. Payment of principal and interest, prepayment, late charges, escrows for taxes and insurance, liens, insurance requirements, occupancy, lender's rights, private mortgage, etc.
- ii. Release of indebtedness.
  1. Defeasance clause – states that when the mortgage is satisfied the mortgagee executes a satisfaction or release of mortgage.
  2. Release Deed or Reconveyance Deed – utilized in a Deed of Trust
- iii. Alienation Clause (Due on Sale Clause)
  1. If the borrower sells the property, the lender has the choice of either declaring the entire debt due and payable or allowing the buyer to assume the loan.

3. Understanding Monthly Mortgage Payments

- a. Principal – the amount of the loan.
- b. Interest Rate – percentage of the loan amount that must be repaid.
  - i. Usually calculated on an annual basis.
  - ii. Rates float with the open market and are negotiable with the lender originating the loan.
  - iii. Charging an interest in excess of the maximum rate allowed by state law is called usury and is illegal.
- c. P & I (Principal and Interest) Payment – monthly payment to the lender that includes both principal and interest.
- d. Amortized loans – a loan which has been configured that at the end of the loan's term all interest and the full amount of principal due have been paid.
  - i. Monthly payments don't change over the life of an amortized loan.
  - ii. A portion of each payment is applied first to interest and then the remainder to principal.
- e. Escrow or Impound Accounts – accounts created by lenders to set aside funds collected from the borrower for a property's future bills (usually taxes and insurance.)
  - i. Lender assumes responsibilities for making these payments.
- f. PITI (Principal, Interest, Taxes, Insurance) – payment that includes the amount for principal, interest, and a monthly portion of the tax and insurance requirement.

- g. PMI (Private Mortgage Insurance) – protects lenders against loss of a portion of a mortgage that exceeds the acceptable loan to value ratio.
  - i. Usually required on Conventional loans when less than 20% is placed as a down payment.
  - ii. Made part of the borrower’s monthly payment.
  - iii. As property values rise and the loan-to-value ratio becomes 80% or less, the borrower can request that the PMI be dropped.
- h. Points – an upfront payment utilized to buy down or lower interest rates.
  - i. 1 point = 1% of the loan amount
  - ii. 1 point reduces an interest rate by 1/8 percent.
    - 1. It would require 8 points to reduce the interest rate by 1%.

#### 4. Types of Loans

- a. Conventional – permanent loans that are not FHA or VA.
  - i. Market rates determine loan’s interest rate.
  - ii. Qualification based on buyer’s ability to pay.
  - iii. Lender may require PMI (Private Mortgage Insurance) as well as escrows for taxes and insurance.
  - iv. Usually requires an appraisal to determine value.
  - v. Rarely assumable.
- b. FHA (Federal Housing Authority) – INSURES lenders against loss on loans.
  - i. For new or existing one-to-four-unit family housing.
  - ii. Borrower must meet FHA standards.
  - iii. Minimum 3.5% down payment.
  - iv. Has a MIP (Mortgage Insurance Premium) – paid up front, which can be rolled into the loan, and a monthly amount, which cannot be financed.
    - 1. Does not go away when the property has over 20% equity.
  - v. Property must be appraised by an FHA appraiser.
  - vi. No prepayment penalties.
  - vii. Assumable with qualification.
  - viii. Lender may charge discount points and a 1% loan origination fee.
- c. VA (Veterans Affairs) – GUARANTEES home loans to lenders.
  - i. For entitled veterans or an un-remarried surviving spouse.
    - 1. National Guard members and reservists with at least six years of service are also eligible for VA-guaranteed loans.
  - ii. Interest rate is set by the lender.
  - iii. VA does not originate these loans.
    - 1. VA guarantees a portion of the loan value to the lender.
  - iv. Can be 100% loan to value, requiring no down payment.

- v. No limits on what can be borrowed by the veteran, but they will only guarantee a maximum of 25% of the county loan limit for loans over \$144,000.
    - 1. If above that limit a down payment may be required.
  - vi. VA funding fee may be required.
  - vii. Property must be appraised by a VA approved appraiser.
    - 1. Completes a CRV (Certificate of Reasonable Value).
    - 2. VA's guarantee is based on either the amount of the CRV or the selling price of the property, whichever is less.
  - viii. May be assumed by a veteran, qualified non-veteran, or by a qualified un-remarried surviving spouse.
  - ix. No prepayment penalties.
- d. USDA (United State Department of Agriculture) – offers loans, grants and guarantees.
- i. For single and multi-family housing.
  - ii. For Low- and moderate-income rural Americans.
  - iii. Loans and grants are also offered to make health and safety repairs to homes.
  - iv. Some rental assistance is also offered through the program.
- e. Partially Amortized Loan – payments are not enough to repay the debt. Results in a remaining balance at the end of the loan term.
- f. Negative Amortized Loan – causes the loan balance to increase over the loan term.
- g. Adjustable-Rate Mortgage (ARMs) – a variable interest rate loan. The lender is allowed to change the interest rate at determined intervals and be a specific amount. Federal regulations limits that amount of change that is allowed.
- h. Interest Only Loans – payments only apply to the interest owed and not to principal. Full balance must be paid off at the end of the loan term (Balloon Payment).
- i. Buydown Loan – Prepayment of interest on a loan, reducing the interest rate and the borrowers' periodic payments.
- j. Wraparound – Seller receives a junior mortgage from the buyer and uses the buyer's payments to make the original first mortgage's payments. Only possible if the senior mortgage allows it and does not have an Alienation Clause.

- k. Home Equity Loan / Home Equity Line of Credit - a loan utilized to borrow against the accrued equity in a home.
- l. Package Loan – finances the purchase of real estate and personal property.
- m. Construction Loan – Finances construction of improvements. Considered short-term, high risk, expensive financing.
- n. Bridge Loan – used to cover the gap between construction financing and long-term financing. Considered short term financing.
- o. Permanent (take out) Loan – a loan that “takes out” a construction or short-term lender.
- p. Reverse Annuity – a homeowner pledges the equity in their home as security for a loan that is paid out in regular monthly amounts over its term to the homeowner.
- q. Seller Financing – (also known as a Purchase Money Mortgage) a loan made by the seller to the buyer for all or part of the purchase price.
- r. Contract for Deed / Land Contract – an Installment sale where the seller finances the buyer and retains legal title until the contract terms are fully performed. Buyer receives the right to possess the property but does not receive the deed to the property until all the payments have been made.
- s. Blanket Mortgage – a loan that covers more than one property or lot. Includes a partial release clause which allows sold lots to be removed from the indebtedness.

## 5. The Lending Process

- a. Borrower completes a loan application and submits for review.
  - i. Usually completed on the Uniform Residential Loan Application required for properties that would be sold to FNMA/FHLMC on the secondary market.
  - ii. Borrower provides information on their age, employment history, assets, monthly income and expenses, and a credit report.
  - iii. If an application is denied the lender must provide specific reasons for its denial.
- b. Lender must rely on eight types of information to determine if the borrower can repay the loan (Qualified Borrower):
  - i. Current income or assets.
  - ii. Current employment status.
  - iii. Credit history.

- iv. Monthly payment for the mortgage.
  - v. Monthly payments being made on other loans on the same property.
  - vi. Monthly payments for other mortgage related expenses.
  - vii. Other debts.
  - viii. Monthly debt payments compared to monthly income (debt to income ratio.)
- c. Income Ratio - limits the percent of gross income a borrower may spend on housing costs (PITI and possible HOA fees, utilities, and MIP).
- i. Monthly housing expenses ÷ monthly gross income.
  - ii. Most lenders require the ratio be no greater than 25% - 28%.
    - 1. FHA has a ratio of 31%
    - 2. VA does not utilize this qualifying ratio.
- d. Debt Ratio – considers all of the monthly obligations of the income ratio plus any additional payments the borrower must make for other debts.
- i. Borrowers monthly housing expense plus monthly debt obligations ÷ monthly gross income.
  - ii. Most conventional lenders require this ratio be no greater than 36%.
    - 1. FHA loans have a ratio of no greater than 43%.
    - 2. VA loans utilize 41% and a variable “residual income” calculation.
- e. Lenders also evaluate:
- i. How long the applicant has been employed.
  - ii. How frequently the applicant has changed jobs in the past.
  - iii. How likely secondary income (bonuses, overtime) will continue.
  - iv. How education level, training and skills, age and type of occupation may affect the income stream in the future.
  - v. Cash resources needed to make the down payment.
    - 1. Gifts may require a gift letter attesting that the money does not need to be repaid.
  - vi. A written credit report detailing:
    - 1. Outstanding debts.
    - 2. Payment behavior.
    - 3. Legal information of public record.
    - 4. Bankruptcies, divorces, foreclosures, short sales, repossessions.
    - 5. Problems with payment behavior.
  - vii. If a lender denies a loan based on a credit report, the lender must disclose in writing that the applicant is entitled to a statement of reason for any creditor responsible for the negative credit report.
- f. Consumer Financial Protection Bureau (CFPB) requirements.
- i. Loan Estimate – must be provided within three days of receiving the loan application.

- ii. Closing Disclosure – must be provided at least three days before loan consummation.
  - iii. Documents include settlement charges, title charges, recording and transfer fees, required reserve deposits, tax and homeowner’ insurance impound deposits and other closing costs.
  - iv. Costs in the Closing Disclosure must match those in the Loan Estimate within certain tolerances.
- g. Underwriting
- i. All documents and information sent for review.
  - ii. An underwriting evaluates the loan’s risks and the borrower’s qualifications.
  - iii. Underwriters may require additional documents or information before they agree to issue a loan commitment.
- h. Loan Commitment – a written agreement to provide a specified loan.
- i. Can be rescinded any time prior to loan closing.

## 6. Foreclosure and Short Sales

- a. Judicial Foreclosure
- i. Used with properties that are mortgaged.
  - ii. Lender sues the borrower in court and obtains a judgement and a court order to sell the property.
  - iii. Property is sold at public sale to the highest bidder.
  - iv. Acceleration Clause allows the lender to call the note due before the scheduled end of the term due to default.
- b. Non-Judicial Foreclosure
- i. Used with properties that utilize a Deed of Trust
  - ii. Third party trustee is called to foreclose and sell the property for the lender.
  - iii. Notice of default must be recorded and a public sale advertised in the newspaper.
  - iv. Property is sold at a public sale to the highest bidder.
- c. Strict Foreclosure
- i. The court awards title to the lender.
- d. Equitable Redemption – process prior to the public sale where the borrower can pay the back payments plus fees and penalties to reinstate the mortgage.

- e. Statutory Redemption – process that allows the borrower an opportunity to pay off the entire loan balance plus fees and penalties and then keep the property.
- f. Deed in Lieu of Foreclosure – borrower gives the lender a deed to the property.
- g. Deficiency Judgement – if a property is sold and the proceeds are insufficient to pay the loan and foreclosure costs, the lender can sue the borrower for the difference.
- h. Short Sale – When a borrower needs to sell the property and owes more on the property than it's worth.
  - i. Contract is contingent on lender's approval.
  - ii. Lienholder is not relieved of their entire monetary obligation unless forgiven by the lender.
  - iii. Lender could still sue for a deficiency judgment.

## 7. The Money Supply

- a. Primary Mortgage Market – financial institutions that make loans directly to consumers.
  - i. Savings and loans, commercial banks, mutual savings banks, life insurance companies, mortgage bankers, credit unions.
  - ii. Mortgage Banker – loan officer who presents his or her bank's loan products,
  - iii. Mortgage Broker – helps borrowers understand and choose a loan produce from various offerings of numerous lenders/investors.
  - iv. Primary lenders assume the initial risk of the mortgage loan.
    - 1. Portfolio Loans – loans originated by lenders (Portfolio Lenders) for retaining the investments in their own portfolios.
      - a. Loan Servicing – holding loans and collect payments.
- b. Secondary Mortgage Market – Lenders, investors and government agencies that buy loans originated by someone else.
  - i. FNMA, FHLMC, GNMA, Investment firms, Life Insurance companies, pension funds, etc.
  - ii. Organizations by pools of mortgages from primary lenders and sell securities backed by these pooled mortgages to investors.
  - iii. Secondary market only buys loans that meet established requirements for quality of collateral, quality of the borrower and specific requirements for documentation.
  - iv. Three primary players in the Secondary Mortgage Market:
    - 1. Federal National Mortgage Associations (FNMA or Fannie Mae).
      - a. Government sponsored.
      - b. Originally a privately-owned corporation.

- c. Buys Conventional, FHA and VA loans.
  - d. Gives banks mortgage-backed securities in exchange for blocks of mortgages.
  - e. Sells bonds and mortgage-backed securities and guarantees payment of interest and principal on mortgage-backed securities.
2. Government National Mortgage Association (GNMA)
    - a. Division of Housing and Urban Development.
    - b. Guarantees payment on FNMA high-risk, low-yield mortgages.
    - c. Absorbs the difference in yield between the mortgages and market rates.
    - d. Guarantees privately generated securities backed by pools of VA and FHA-guaranteed loans.
  3. Federal Home Loan Mortgage Corp. (FHLMC or Freddie Mac)
    - a. Government sponsored enterprise that buys mortgages and pools them, selling bonds backed by the mortgages on the open market.
    - b. Guarantees performance on FHLMC mortgages.

## 8. Financing Laws and Rules

- a. Truth in Lending Act (TILA/Regulation Z)
  - i. Requires costs in credit transactions to be disclosed to borrowers.
  - ii. Regulation Z requires that all finance charges as well as the true APR (Annual Percentage Rate) be disclosed to the consumer before the transaction is completed.
  - iii. A “cooling off” period is required when liens such as a refinance or home equity loan will be placed on a principal residence.
    1. Borrower has the right to rescind the transaction up to midnight of the third business day following the transaction.
      - a. Does not apply to loans that finance the purchase or initial construction of a house.
  - iv. Regulation Z pertains to advertising requirements.
    1. Specific credit terms may not be advertised unless the ad includes full disclosure of:
      - a. The down payment
      - b. Repayment terms
      - c. The Annual Percentage Rate (APR)
      - d. Whether the rate can be increased after the consummation of the loan.
    2. Penalties for non-compliance include imprisonment of up to a year and a fine of \$5,000.

- b. Real Estate Settlement Procedures Act (RESPA)
  - i. Created to ensure buyers understand settlement costs.
  - ii. Applies to purchases of residential real estate (one to four-family homes) financed by “federally related” first mortgage loans.
  - iii. Prohibits lenders from paying kickbacks and unearned fees.
  - iv. Requires that lenders provide a loan applicant with a loan information booklet and the Loan Estimate and Closing Disclosure forms.
  
- c. Equal Credit Opportunity Act (ECOA)
  - i. Prohibits discrimination against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, or dependency on public assistance.
  
- d. Mortgage Fraud
  - i. Acts such as identity theft, false documentation, occupancy fraud.
  
- e. Predatory Lending
  - i. Any practice in which lenders try to coerce borrowers into agreeing to loans that are unaffordable and violate industry standards.

# Chapter 8 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. A discount point is 1% of the loan amount.
2. A discount point reduces the borrower's interest rate and increases the lender's yield.
3. The lower the down payment, the higher the risk of foreclosure.
4. A promissory note can be used to foreclose upon a property.
5. A security instrument can be used to foreclose upon a property.
6. The Loan to Value (LTV) ratio shows the relationship between the loan amount and appraised value.
7. Mortgage default insurance may be required if the down payment is less than 20%.
8. The mortgagor is the lender.
9. A deed of trust is a two-party security agreement.
10. The promissory note is evidence of the borrower's promise to repay the lender.
11. The difference between the property's current loan balance and its current value is known as equity.
12. An interest-only loan is also known as a straight loan.
13. A partially amortized loan will have a smaller balloon payment than a straight loan but larger than a fully amortized loan.
14. A fully amortized loan will have a balloon payment due at the end of its terms.
15. A negative amortized loan causes the loan balance to increase over the loan's term.
16. Adjustable Rate Mortgages (ARMs) allow the lender to change the interest rate at specified intervals and by a specified amount.
17. A mortgage is a two-party security agreement.
18. The buyer will have legal title with a contract for deed.
19. An installment contract is also known as a land contract and/or a contract for deed.

20. A blanket mortgage is typically used by a developer to secure a loan on multiple properties.
21. PMI (private mortgage insurance) is an insurance policy against an FHA loan.
22. MIP (mortgage insurance premium) is an insurance policy against a conventional loan.
23. An alienation clause is exercised by the lender when the borrower defaults.
24. A due on sale clause is also known as an alienation clause.
25. A conventional loan is a federally related loan that is not backed by the Federal Housing Authority (FHA) or the Veterans Administration (VA).
26. A package mortgage is used to pledge a furnished condominium as collateral.
27. Discount points, loan origination fees, loan interest and property taxes are tax deductible.
28. Charging an interest rate in excess of statutory limits is called usury.
29. Purchase money mortgage is also known as seller financing.
30. A vendee has equitable title and the vendor retains legal title with a contract for deed.
31. An escrow/reserve account is primarily used for the payment of taxes and mortgage insurance.
32. A due on sale clause is exercised by the lender declaring the loan due immediately when the borrower sells and alienates the property.
33. An FHA loan is guaranteed by HUD, while a VA loan is insured by VA.
34. Hypothecation is when a borrower does not take legal title to the property until their loan is paid in full.
35. A lien theory state allows the borrower to retain legal title and the lender to have a non-possessory interest on a pledged property.
36. A mortgage broker provides the financing and servicing of a loan.
37. A mortgage broker is the intermediary between the borrower and the lender.
38. A lender may require PMI on a conventional loan if the down payment is less than 20%.
39. An FHA loan allows for a lower down payment than most conventional loans.
40. Prepayment penalties are not allowed on FHA or VA loans.
41. A VA appraisal is called a Certificate of Reasonable Value (CRV).

42. When a mortgage is paid in full, the lender provides a reconveyance deed to the borrower.
43. The Truth in Lending Act requires the lender to disclose all transaction closing costs.
44. The Equal Credit Opportunity Act protects retired-aged consumers from being discriminated against when applying for a loan.
45. The Department of Housing and Urban Development insures FHA approved lenders against loss on defaulted loans.
46. The Department of Veterans Administration guarantees VA approved lenders against loss on defaulted loans.
47. The Fair Credit Reporting act requires lenders to provide loan applicants a statement of reason for a loan rejection within 30 days.
48. Regulation Z is also known as the Truth in Lending Act.
49. Disclosing APR or the full price does not trigger full disclosure per the Truth in Lending Act.
50. Regulation Z does not allow for a borrower the right to cancel or rescind a first mortgage loan to purchase real property.
51. The acceleration clause allows the lender to call a loan due immediately when the borrower defaults.
52. When a borrower exercises the defeasance clause in his loan, he is said to have paid off and defeated his loan.
53. A deed of reconveyance is provided when a deed of trust is paid in full.
54. VA loans allow for 100% LTV.
55. Because VA does not require down payments, mortgage default insurance is required.
56. A qualified non-veteran may assume a VA loan.
57. The USDA (United States Department of Agriculture) offers a variety of loan programs to build or improve housing in rural areas.
58. A construction loan is also known as a take-out loan.
59. A construction loan is a short-term loan.
60. A mortgagee pays a mortgagor in a reverse mortgage.

61. The Closing Disclosure must be provided to the borrower three business days after loan application.
62. Regulation Z applies to non-business loans.
63. To comply with Regulation Z, finance charges must include interest, loan fees, discount points, service charges, finder's fees, property insurance, credit insurance and must be stated as the APR.
64. APR will always be higher than the interest rate.
65. Fannie Mae, Ginnie Mae and Freddie Mac are agencies in the secondary mortgage market.
66. RESPA allows lenders to pay kickbacks to parties that helped the lender obtain a borrower's business.
67. A Loan Estimate must be provided to a borrower three business days before closing.
68. The Consumer Financial Protection Board (CFPB) has authority to write rules to protect consumers from unfair or deceptive financial products, acts or practices.
69. A borrower with an erratic employment history is protected by the Federal Fair Housing Act.
70. A judicial foreclosure requires the lender to sue the borrower in a court of law and obtain a judgement and court order to foreclose upon the property and sell it at a public sale.
71. A non-judicial foreclosure allows the lender to utilize a public trustee to foreclose and sell the property at a public sale on behalf of the lender due to default.
72. The equitable redemption period occurs after the public sale.
73. The statutory redemption period occurs after the public sale.
74. The winning bidder at the public sale takes immediate possession of the property.
75. The borrower can stop the foreclosure before the public sale by becoming current on the loan and paying any fees and penalties.
76. The borrower can stop the winning bidder from owning the foreclosed property by paying off the entire loan and paying any fees and penalties.
77. If a foreclosed property is sold for less than what is owed on the loan, the lender can file a deficiency judgment to require the borrower to pay the amount still owed.
78. A deed in lieu of foreclosure is when the borrower gives the deed to the lender instead of the lender foreclosing upon the borrower.

79. All junior lienholders will disappear when a deed in lieu of foreclosure is utilized by the senior lienholder.
80. When attempting to sell a property, the borrower may ask the lender to accept less than what is owed on the loan. If the lender accepts an amount less than the loan amount, this process is called a short sale.
81. Upon a short sale, the lender may still sue for a deficiency judgment.
82. If a lender agrees to make a loan at 95% LTV on a property purchase of \$450,000 where the property appraises for \$445,000. The amount of the loan is \$422,750.
83. A property sells for \$375,000. The borrower puts \$40,000 down. The LTV is 85%.
84. A borrower pay four (4) discount points on a \$300,000 loan would be charged \$13,000.
85. Jane negotiated that the seller would pay two discount points to her lender to reduce her interest rate. Her rate has gone down by  $\frac{1}{2}$  a percent.
86. Tom's home is worth \$415,000 and he owes \$375,000 on it, so he has \$40,000 in equity.
87. D'Ann purchased her new home on 123 Main Street for \$615,000 using her VA eligibility. Her down payment was probably \$123,000.
88. D'Ann purchased her new home on 123 Main Street for \$615,000 using an FHA loan. Her down payment was probably \$21,525.
89. D'Ann purchased her new home on 123 Main Street for \$615,000 using a conventional loan that requires 8% down payment or \$45,000.
90. MaryAnne borrows \$250,000 at 7% interest. Her monthly payment is \$1,600, applied first to interest and then principal. Her outstanding balance and the end of two months is \$249,858.34.



# 9

## Contract Law

### General Contract Law Concepts

### Purchase Agreement Offers and Counteroffers

### Listing/Buyer Representation Contracts

---

## General Contract Law Concepts

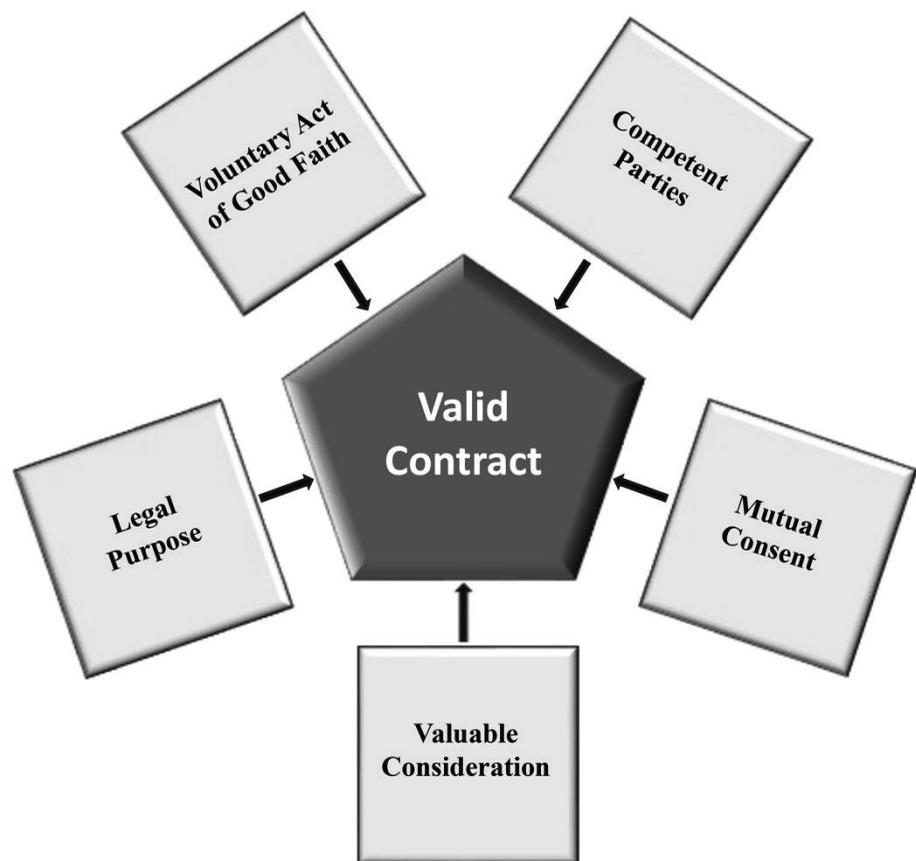
---

Although they are not lawyers, real estate licensees assist their clients in the sale and purchase of real estate using real estate contracts. Licensees must create contracts that are legally binding. Here are the essential elements of a **valid** contract:

1. **Competent Parties** – The parties must have capacity to contract, i.e., they must be of legal age and mentally competent (18, sane and sober). The parties must also have legitimate authority. For example, if one person is signing for another, a bona fide Power of Attorney must be provided.
2. **Mutual Consent** - Also known as offer and acceptance or “meeting of the minds,” this requires a contract to have a clear and definite offer and an unqualified acceptance of that offer. A court may nullify a contract where the acceptance of terms was vague.
3. **Valuable Consideration** - A contract must contain a two-way exchange of valuable consideration, which is used as compensation for the performance of the other party. Where valuable consideration is something of tangible value, **good consideration** is legally something of questionable value like “love and affection.” Good

consideration is usually not considered adequate for real estate contracts.

4. **Legal Purpose** - The content, promise, or intent of a contract must be lawful.
5. **Voluntary Act of Good Faith** – The parties must create the contract in good faith as a free and voluntary act. A contract may be voidable if a party to the contract acted under duress, coercion, fraud or misrepresentation.



If a contract is missing one of the above essential elements, it is considered **void**. Grossly insufficient consideration, like \$500 for a \$300,000 property, may invalidate a contract. Similarly, a contract that proposes an illegal purpose is void. The legal effect then is that there is no contract at all. However, a contract could be **voidable** if it initially appears to be valid but could be rescinded by one of the parties who is deemed to have acted under some kind of disability. Only the party who claims the disability (duress,

coercion, lack of legal age, etc.) may rescind the legal effect of the contract. The rescission must occur within a legal time frame, known as the **Statute of Limitations**. If the party who could disaffirm the contract chooses to instead perform the contract, the contract is no longer voidable but valid.

For example, you want to transfer ownership of your house to your daughter, Kerri, who is 17 years old. You draw up a contract knowing full well that Kerri is not of legal age. Your contract is voidable by Kerri, not by you (since you are not a minor). If Kerri changes her mind, she can rescind or cancel the contract as long as the property transfer hasn't been completed. This scenario reinforces the concept that minors can't sell a house because a deed's grantor must be of legal age, however they can buy a house.

A contract can be valid but still be **unenforceable** in a court of law. That's because most state laws support the common law concept called **Statute of Frauds**, which requires that certain contracts (including real estate sales contracts that convey real property) must be in writing to be enforceable. Therefore, while an oral real estate purchase contract may meet the test for validity, a court would not be able to enforce the performance of the contract; neither party could sue the other to force performance. If the parties fully execute and perform an unenforceable contract, the outcome may not be altered. Please note that contracts do not have to be notarized or recorded to be enforceable. SPECIAL NOTE: An oral lease for one year or less is considered enforceable.

**Contract obligations** are those duties that each party is legally responsible to complete. Lack of adherence to contract terms can create financial penalties for non-performance. For example, all parties agree to act in good faith to perform the terms of the contract. If one of the parties enters a contract to purchase real property yet continues to tour other homes, does not timely respond to communications and then terminates the contract, the other party could question whether the contract was entered into in good faith.

## *Types of Contracts*

When both parties to a contract promise to do something, the contract is **bilateral**; one promise is given in exchange for another. In a real estate contract, the buyer agrees to purchase the property and the seller agrees to sell the property to the buyer.

A **unilateral** contract is one in which only one party makes a promise. If the second party complies, the first party is obligated to keep the promise. A good example of a unilateral contract is an **option contract** where the optionor (owner) gives the optionee (prospective buyer) the right to buy his property at a fixed price within a specific period of time. Let's say your client is relocating for work but is waiting on a firm letter of employment. On a weekend trip, you find the perfect house. Your client is worried that the home will go under contract with another buyer, so he asks you to write up an option contract giving the seller \$2,000 to NOT sell the house to anyone but him for the next five days. Your client (the optionee) pays the fee for the option rights and assumes no obligation to make any other payment until she decides to either exercise the option right or allow it to expire.

When the parties to a contract explicitly discuss terms and show their intentions to be bound by a contract in words, an **expressed** contract has been created. Expressed contracts may be either oral or written. Real estate contracts are typically express written agreements.

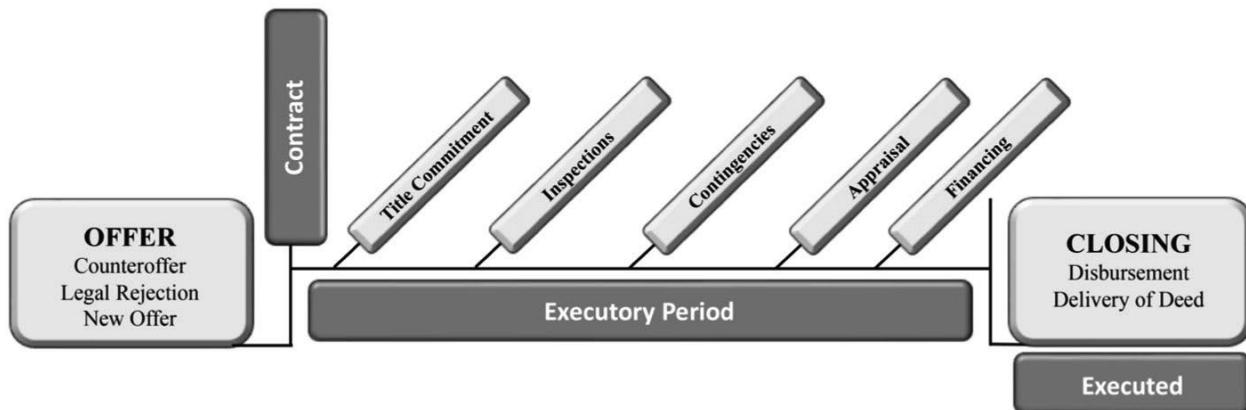
However, sometimes a contract is created through a party's acts and conduct. This is called an **implied** contract. Like our discussion in Chapter 2 about creating implied agency, creating an implied contract is very similar. Imagine you have been invited over to Dylan's house to watch a football game, where you meet Carmen and start talking about the local real estate market. Carmen explains that she lives just down the street and was thinking about selling her home. You ask a few pertinent questions and get permission to follow up in a few days. The next morning, you send out an email to your database of 250 people in which you describe this new property that will be going on the market soon. A past client calls you and asks if he can see the house. You call up Carmen to see if you can bring a prospective buyer to her home. In this scenario, you have nothing in writing with Carmen, but your actions have created an implied contract as well as implied agency. While this is not enforceable, it may be legal.

---

## Purchase Agreement Offers and Counteroffers

---

In addition to the essential elements listed above, contracts that convey real estate must also be in writing, contain the property's legal description, and be signed by one or more parties. Remember, per the Statute of Frauds, leases of 12 months or less do not have to be in writing to be enforceable. A real estate contract also specifies each party's rights and responsibilities through the sales process.



Before a contract to purchase is formed, the **offeror** (usually the buyer) proposes contract terms and an intention to enter into a contract to the **offeree** (usually the seller). If an offer contains an expiration date and the phrase “time is of the essence,” the offer expires at exactly the time specified. In the absence of a stated time period, the contract provides the offeree with a “reasonable” amount of time to accept. All offers must be promptly presented by the agent to the principal when received.

If the offeree accepts all terms without changes, evidenced by signing the offer, and gives the offeror **notice** of the acceptance, the offer becomes a legally binding **executory** contract. At this point the buyer has equitable title and is now called the **vendee** while the seller still holds legal title and is considered the **vendor**. The buyer's equitable title interest prohibits the seller from selling the property to someone else while the contract remains in effect.

A contract is said to be executory when something remains to be done by one or both parties. It's the period from when the offer is accepted until the contract closes. A contract is **executed** when both parties have fulfilled their promises and thus performed the contract.

If the offeree wants to make changes to an offer, those changes will constitute a **counteroffer**. A counteroffer terminates the original offer. It is a new offer made in response to an offer received; the original offer is, in effect, rejected and can no longer be accepted unless it is revived by the offeror. When a seller presents a counteroffer to a buyer, she is now the offeror, and the buyer is now the offeree.

Licensees are obligated to submit offers and counteroffers objectively and as quickly as possible. They must be aware of their duties to their client (buyer or seller) based on state law. Licensees must be honest with all parties. The decision about how offers will be presented, how offers will be negotiated, whether counteroffers will be made and ultimately which offer, if any, will be accepted, are made by the seller – not by the listing agent. The decisions about how counteroffers will be presented, how counteroffers will be negotiated, and whether a counteroffer will be accepted, are made by the buyer – not the selling agent.

The existence of other offers on the property should only be divulged with the seller's permission. In multiple offer situations only one offer will result in a sale and one (or more) potential purchasers will be disappointed that their offer was not accepted.

The offer may be **terminated** by any of the following actions or circumstances:

- Acceptance: the offeree accepts the offer, converting it to a contract.
- Rejection: the offeree rejects the offer.
- Revocation: the offeror withdraws the offer before acceptance.
- The offer expires.
- Counteroffer: The offeree changes the offer.
- Death or insanity of either party

Many people assume that once an offer is made, that offer must be either accepted, rejected, or countered *before the offeree could consider another offer*. This is untrue. An offer may be revoked, or **withdrawn**, at any time before the offeree has communicated acceptance. The revocation

extinguishes the offer and offeree's right to accept. The same is true for a counteroffer.

Imagine that a buyer makes an offer on a property and includes an acceptance deadline of tomorrow at 4:00 pm. At 12:00 pm tomorrow, the buyer finds another property she likes better. Before making an offer on the new property, she can withdraw her offer on the first property as long as she has not been notified of that seller's acceptance.

Now consider that in the above scenario, the seller receives the buyer's offer with the acceptance deadline of tomorrow at 4:00 pm and at 2:00 pm sends a counteroffer. The counteroffer has its own deadline of 24 hours. Before that deadline, the seller receives a better offer from a different buyer. Since the seller has not heard back from the first buyer, he can withdraw his counter and accept the new offer.



**Electronic signature** and paperless transactions are allowed thanks to the Esign Act, a federal law passed in 2000. This act grants legal recognition to electronic signatures and records if all parties to a contract choose to use electronic documents and to sign them electronically. Specifically, the Esign Act states that “no contract, signature, or record shall be denied legal effect solely because it is in electronic form.” Parties to the agreement would have to agree to utilize electronic signatures or electronic transmission of documents.

---

## Purchase Contracts

---

Many real estate purchase contracts discuss **earnest money**, which is a “deposit” collected from the buyer at the time of contracting and held in a trust or escrow account on the buyer’s behalf until closing. Earnest money is not a fee; it does provide potential compensation for damages to the seller if the buyer fails to perform. If the buyer does perform, that money is transferred to the closing company and credited to the buyer.

Clauses or **contingencies** are conditions in a contract that require a certain event or events to happen before the contract is complete. Contingencies are completed during the contract’s executory period. Contingency clauses have three distinguishing features:

- Actions needed to satisfy the contingency.
- Time frame within which actions must be performed.
- Statement identifying (if necessary) who will be responsible for paying any related costs.

All contingencies must be met before the property closing takes place, and within the time frames stipulated in the contract. Examples of contingencies might be a financing contingency that makes the contract subject to the buyer obtaining financing with certain terms (interest rate, etc.) within a stated period of time, or an inspection contingency that makes the contract subject to the buyer conducting satisfactory inspections.

**Addenda** to the sales contract become binding components of the overall agreement. If something is added to the contract as an addendum it must always remain with the sales contract and be provided to any party who receives a copy of the contract. Property condition disclosures or extended legal descriptions are common addenda.

**Amendments** to the sales contract change the terms or conditions of the original agreed-upon contract; they must be completed in writing and agreed to by all parties via their signatures. Everyone (buyer, seller, lender,

attorneys, title companies, etc.) who relies on the contract for completion of the closing must receive a copy of any amendments. Let's say that one of the contract's contingencies is the buyer's right to object if an appraisal indicates that the appraised value is less than the agreed-upon purchase price. This happens and the buyer objects, so the buyer and seller negotiate a new purchase price. An amendment is drafted to memorialize the price change. Both the buyer and the seller sign it, and a copy of the amendment is also sent to the buyer's lender and the title company.

In some cases, a contract might involve the transferring of a real estate contract from an original party to another party. This is referred to as **assignment**. Most sales contracts are considered assignable unless assignment is specifically prohibited in the contract. The process of assignment may also require a **novation**, which is simply replacing someone or something in a contract with someone or something else.

The failure, without legal excuse, of one of the parties to perform according to the contract is called **breach**. A "time is of the essence" contract must be performed in the time specified in the contract. Any party who does not perform on time is guilty of breach of contract.

If the seller defaults and is in breach of contract, the buyer's remedies are to rescind or terminate the contract and recover his or her earnest money; sue the seller for damages; or sue for **specific performance**, in which case any earnest money is recovered, and the buyer can sue the seller to comply with the contract's terms. If the buyer defaults, the seller can declare the contract forfeited, rescind the contract and keep all or part of the deposit as **liquidated damages**, sue for specific performance (if the contract allows for it), or sue for damages.

Unlike breach of contract, **termination** of a contract (also called cancellation or discharge) may occur for any of the following causes:

- Performance – a contract terminates when fully performed by the parties.
- Infeasibility – a contract may be cancelled if it is not possible to perform.
- Mutual Agreement – parties to a contract can agree to terminate a contract.

- Rescission – the act of cancelling or nullifying a contract. A damaged party may be able to rescind a contract. This returns the parties to their pre-contract condition (original state) including the refunding of any monies already transferred.
- Revocation – cancellation of the contract by one party without the consent of the other. In the absence of justifiable grounds, a revocation may not relieve the revoking party of contract obligations.
- Abandonment – occurs when parties fail to perform contract obligations. This may allow the parties to cancel the contract.
- Lapse of Time – if a contract contains an expiration provision and date, the contract automatically expires on the deadline.

Important note: The death of one of the parties to a sales contract does not terminate the contract. The contract's responsibilities will pass (**inure**) to the heirs of the deceased party.

### ***Other Real Estate Contracts (Options / Land Contracts)***

A **Real Estate Option** contract, also known as an **Option-to-Buy** is an arrangement where the seller (**optionor**) gives the buyer (**optionee**) the right to purchase property at a given price and terms for a set period. This one-of-a-kind contract is solely between one seller and one buyer. For this right the optionee pays the optionor some form of valuable consideration.

An option-to-buy places the optionee (buyer) under no obligation to purchase the property, whereas the seller is required to sell to the buyer within the contract terms, if the buyer exercises the option. If the buyer does not exercise their right to the option prior to the expiration date of the option, the seller is under no further obligation to the buyer. This is a classic illustration of a unilateral contract.

Real Estate Option contracts have four components:

- The contract must be in writing (Statute of Frauds)
- The contract must specify the location of the property (legal description)

- The contract must stipulate an agreed-upon time frame for the buyer to exercise their option to purchase. It must have an expiration date.
- The purchase price of the option must be agreed upon.

The optionee enjoys an equitable title interest in the property because the option creates the right to obtain legal title. However, the option itself does not convey an interest in real property, only a right to obtain it.

Options should be recorded, because the equitable interest created by the option can affect the marketability of title as the right of the option must be executed or extinguished before the property could be sold to another party other than the optionee.

Unless specifically prohibited by the contract the option contract is assignable to another party.

An **Installment Land Contract** (also known as a **Land Contract** or **Contract for Deed**) is a bilateral agreement between a Seller (Vendor) and a Buyer (Vendee). The buyer typically gives the seller a nominal down payment and regular period payments over several years, including interest.

An Installment Contract offers a means for a marginally qualified buyer to acquire property. Technically, the seller is acting as a lender. The buyer will immediately take possession of the property, but the seller will retain legal title to the property during the entire duration of the contract. The buyer will have an equitable title interest. The seller will deliver the deed for the property to the buyer once the final payment has been made by the buyer.

By utilizing an Installment Contract the buyer can avoid conventional down payment and income requirements imposed by traditional lenders. Sellers may be able to leverage the Installment Contract for tax benefits. Since the seller is not liable for capital gains tax until the purchase price is received, the installment sale lowers the seller's tax liability in the year of the sale.

However, an installment contract offers a buyer less protection than a traditional mortgage. Most installment contracts include a forfeiture clause which allows a seller, upon the buyer's default, to end the contract and regain possession of the property. This might allow the seller to not have

to force a sale of the property to satisfy the default of the buyer, as they would in the foreclosure of a traditional mortgage.

By acting like an agent – even without a written contract – you have created an implied agency relationship. If Gary assumes you are his agent and you don't fulfil your obligations to him, you could be held liable.

---

## **Listing / Buyer Representation Contract**

---

Unlike a purchase contract, a **listing contract** is between a principal and a licensed real estate brokerage firm, where the brokerage is employed to list and sell or help locate real estate on the client's terms within a given time, and for which the client agrees to pay a fee (commission). Listing contracts are personal service contracts that also describe the type of agency or non-agency being established and the scope of the duties to be provided. Because the contract is between the brokerage firm and the principal, when a salesperson is either designated to provide services on behalf of the firm or acts as a subagent, he is only doing so at the direction of the firm. If the salesperson dies or leaves the firm, the brokerage can appoint someone else at the firm to provide services to the client.

General requirements of a valid listing contract are that it be in writing to be enforceable, state the exact amount of commission to be earned by the broker, specify a termination date, state the price of the real estate and terms of the sale and include a legal description of the property (for sellers), name the brokerage firm, and have (at least) the principal's signature authorizing the agency and the payment of the commission when earned.

### ***Different Types of Listing Contracts***

There are several types of listing contracts. In an **Exclusive Right-to-Sell** or **Exclusive Right-to-Buy** contract, one brokerage firm is given the exclusive right to represent the client. The client gives up the right to sell or

buy without paying the broker's commission. The brokerage receives the commission regardless of who brings the buyer or locates the property.

**Exclusive Agency** listing contracts state that only one brokerage is authorized to act as the exclusive agent of the principal, however the *client* retains the right to sell or locate the property without any compensation obligation to the brokerage. The brokerage receives a commission if its firm is the procuring cause or caused the sale to happen with the help of another firm that either brought the buyer or represented the seller.

An **Open Listing** is considered a non-exclusive listing contract where the client may employ any number of brokerage firms and is obligated to pay a commission only to the brokerage that produces a buyer or locates a property (procuring cause). If the client personally secures the property/buyer, without the aid of any broker, the client is not obligated to pay a commission to any firm. Since only one party is bound by the contract (the client if the broker brings a buyer/finds the property), this is a unilateral contract.



Lastly, a **net listing** occurs specifically when the seller states a minimum sale or lease price he or she will accept, with any excess going to the broker as a commission. This is illegal in many states and is professionally discouraged, as it provides an opportunity for the broker to take advantage of the seller's lack of understanding concerning the market value of his or her property.

Unless sellers agree to pay or instruct their listing firm to share a negotiated commission, buyers or tenants must compensate their agent whenever purchasing or renting a property. A buyer representation or listing contract describes the type of property sought, any state disclosure requirements the broker must comply with, and specifies a termination date. Like a listing contract with a seller, buyer listing contracts are also personal service contracts that describe the type of agency/non-agency established and the scope of work.

The following are ways a buyer or tenant's broker can be compensated:

- Retainer fee - Gives buyer or tenant incentive to perform on the contract. The fee may be refundable or nonrefundable.
- Flat or Fixed Fee - The fee can be paid by the buyer or tenant or as a co-op fee by the seller or landlord.
- Hourly Fee - The hourly fee should reflect the market, as well as what other professionals are receiving.
- Percentage Fee - Can be a percentage of sales or rental price or an MLS co-op fee. Creates a disincentive for a buyer or tenant's broker to get a lower price or rent for the buyer/tenant.

As mentioned in Chapter 2, certain events will **terminate** an agency contract. The completion of the reason the agency relationship was created will terminate the relationship (i.e., the sale of the house.). The parties can mutually agree to terminate the agency relationship. Since the listing/buyer representation agreement must have a termination date, the relationship automatically terminates on that date, whether the obligations were performed or not.

In addition, unlike a purchase contract, listing/representation agreements do terminate upon the death or incapacity, bankruptcy, or termination by force of law of either the principal or broker/brokerage firm. Principals can also terminate their agreements with agents if they have been abandoned, usually if an agent stops communicating with the principal by not returning phone calls, emails or texts. If the property being listed is condemned, destroyed, or sold at a foreclosure sale, the listing agreement will terminate as well.

# Chapter 9 Key Point Review

---

1. General Contract Law Concepts
  - a. Requirements for Contract Validity (Valid Contract)
    - i. Competent Parties
      1. Must have capacity to contract.
        - a. Legal age
        - b. Mental Competency
        - c. Legitimate Authority
      2. Must be at least two parties
    - ii. Mutual Consent
      1. Also known as Offer and Acceptance and Meeting of the Minds.
      2. Requires a contract to have a clear and definite offer and an unqualified acceptance of the offer.
      3. A court may nullify a contract where the acceptance of terms was vague.
    - iii. Valuable Consideration
      1. A contract must contain a two-way exchange of valuable consideration.
        - a. Used as compensation for the performance of the other party.
      2. Valuable Consideration – something of tangible value.
      3. Good Consideration – something of questionable value.
        - a. Love and Affection
        - b. Good consideration is usually not considered adequate for real estate contracts.
    - iv. Legal Purpose
      1. The content, promise, or intent of a contract must be lawful.
        - a. A contract that proposes an illegal purpose is void.
    - v. Voluntary Act of Good Faith
      1. Parties must create the contract in good faith as a free and voluntary act.
        - a. A contract may be voidable if a party to the contract acted under duress, coercion, fraud or misrepresentation.
    - vi. Be in Writing
      1. In order to be enforceable a contract must be in writing.
        - a. Statute of Frauds.
    - vii. Contain a Legal Description of the Property.

- viii. Be signed by the parties to the contract.
- b. Void, voidable, unenforceable contracts
- i. Void Contract
    - 1. A void contract is an agreement that does not meet the standards for validity (Valid Contract).
      - a. There is no contract.
        - i. Neither party, nor the court can enforce it.
  - ii. Voidable Contract
    - 1. A voidable contract is one which initially appears to be valid.
      - a. Subject to recession of one of the parties to the contract who is deemed to have acted under some kind of disability.
      - b. Only the party who claims the disability (duress, coercion, lack of legal age, etc.) may rescind the legal effect of the contract.
      - c. The rescission must occur within a legal time frame for the rescission to be valid.
      - d. If the party who could disaffirm the contract chooses to perform the contract, the contract is no longer voidable but valid.
  - iii. Unenforceable Contract
    - 1. An unenforceable contract is a contract which cannot be enforced in a court of law.
    - 2. Unenforceable does not mean void.
      - a. A void contract was NEVER A CONTRACT.
    - 3. An unenforceable contract appears to be valid, but neither party may sue the other to force performance.
- c. Factors affecting enforceability of contracts
- i. Most state laws declare that some contracts are enforceable only if they are in writing.
  - ii. While an oral contract may meet the test for validity the court would not be able to enforce the performance of the contract by the parties.
  - iii. Statute of Frauds
    - 1. Requires that certain contracts must be in writing to be enforceable.
      - a. Real Estate Contracts that convey real estate fall into this category.



- f. Expressed and Implied, Executory and Executed
  - i. Expressed Contract – parties state terms and show intentions in words.
    - 1. May be either oral or written.
    - 2. Real estate contracts are typically express written agreements.
  - ii. Implied Contract – agreement is demonstrated by acts and conduct.
  - iii. Executory Contract – A contract in which something remains to be done by one or both parties.
    - 1. The period from when the offer is accepted until the contract closes.
  - iv. Executed Contract – both parties have fulfilled their promises and thus performed the contract.

## 2. Purchase Agreement Offers and Counteroffers

- a. Notice, delivery and acceptance of contracts
  - i. The offeror proposes contract terms in an offer to the offeree.
  - ii. If the offeree accepts all terms without amendment, the offer becomes a contract.
  - iii. The exact point at which the offer becomes a contract is when the offeree gives the offeror notice of the acceptance.
  - iv. Offer – An offer expresses the offeror’s intention to enter into a contract with an offeree to perform the terms of the agreement.
    - 1. If an offer contains an expiration date and the phrase “time is of the essence,” the offer expires at exactly the time specified.
      - a. In the absence of a stated time period the offeree has a “reasonable” time to accept an offer.
  - v. Acceptance
    - 1. For an acceptance to be valid, the offeree must unequivocally accept all terms of the offer without change and indicate that by signing the offer.
    - 2. The acceptance must be communicated to the offeror.
    - 3. Any changes made to the offer would constitute a counteroffer.

vi. Revocation of an Offer

1. An offer may be revoked, or withdrawn, at any time before the offeree has communicated acceptance.
  - a. The revocation extinguishes the offer and offeree's right to accept.

vii. Termination of an offer

1. The offer may be terminated by any of the following actions or circumstances:
  - a. Acceptance: the offeree accepts the offer, converting it to a contract.
  - b. Rejection: the offeree rejects the offer.
  - c. Revocation: the offeree withdraws the offer before acceptance.
  - d. The offer expires.
  - e. Counteroffer: The offeree changes the offer.
  - f. Death or insanity of either party

b. Electronic signature and paperless transaction

- i. The E-sign Act is a federal law that passed in 2000.
  1. Grants legal recognition to electronic signatures and records if all parties to a contract choose to use electronic documents and to sign them electronically.
  2. "no contract, signature, or record shall be denied legal effect solely because it is in electronic form."
  3. Parties to the agreement would have to agree to utilize electronic signatures or electronic transmission of documents.
    - a. Usually agreed to by all the parties in the sales contract.

3. Sales Contracts

a. Earnest Money

- i. A deposit collected from the buyer at time of contracting.
- ii. Held in a separate trust or escrow account.
- iii. Provides compensation for damages to the seller if buyer defaults.
- iv. Can be utilized for closing costs or down payment.

- b. Clauses or contingencies are conditions in a contract that require a certain event or events to happen before the contract is complete.
  - i. Contingency clauses have three distinguishing features:
    - 1. Actions needed to satisfy the contingency.
    - 2. Time frame within which actions must be performed.
    - 3. Statement identifying (if necessary) who will be responsible for paying any related costs.
- c. Addenda to the sales contract become binding components of the overall agreement.
  - i. If something is added to the contract as an addendum it must always remain with the sales contract and be provided to any party who receives a copy of the contract.
- d. Amendments to the sales contract, which changes the terms or conditions of the original agreed upon contract, must be completed in writing and agreed to by all parties (via their signatures).
  - i. All parties (buyer, seller, lender, attorneys, title companies, etc.) who are utilizing the contract for completion of the closing must receive a copy of any Amendments to the contract.
- e. Breach of contract and remedies for breach
  - i. Breach of contract – the failure, without legal excuse, of one of the parties to a contract to perform according to the contract.
  - ii. Remedies for the breach if the seller defaults:
    - 1. Rescind, or terminate the contract and recover the earnest money.
    - 2. Sue the seller for damages.
    - 3. Sue for Specific Performance
  - iii. Remedies for breach if the buyer defaults:
    - 1. Declare the contract forfeited.
    - 2. Rescind the contract and keep all or part of the deposit as Liquidated damages.
    - 3. Sue for specific performance (if the contract allows for it).
    - 4. Sue for damages.
- f. Termination, rescission and cancellation of contracts
  - i. Termination of a contract (also called cancellation or discharge) may occur for any of the following causes:

1. Performance – a contract terminates when fully performed by the parties.
  2. Infeasibility – a contract may be cancelled if it is not possible to perform.
  3. Mutual Agreement – parties to a contract can agree to terminate a contract.
  4. Rescission – the act of cancelling or nullifying a contract.
    - a. A damaged party may be able to rescind a contract.
      - i. Returns the parties to their pre-contract condition including the refunding of any monies already transferred.
  5. Revocation – cancellation of the contract by one party without the consent of the other.
    - a. In the absence of justifiable grounds, a revocation may not relieve the revoking party of contract obligations.
  6. Abandonment – occurs when parties fail to perform contract obligations.
    - a. This may allow the parties to cancel the contract.
  7. Lapse of Time – If a contract contains an expiration provision and date, the contract automatically expires on the deadline.
- ii. Death of one of the parties to the sales contract will not cancel the contract. May pass to their heirs of the deceased party.

#### 4. Other Real Estate Contracts

- a. Option to Buy
  - i. A unilateral agreement
  - ii. Seller (optionor) give the buyer (optionee) the right to purchase property at a given price and terms for a set period.
    1. Optionee pays a price for the option.
  - iii. The Optionee is under no obligation to buy.
  - iv. The Optionor must sell if the optionee exercised their option.
  - v. The Optionee enjoys an equitable title interest
- b. Installment Land Contracts / Contracts for Deed
  - i. Bilateral agreement
  - ii. Buyer (Vendee) gives the seller (vendor) a nominal down payment for the contract.
  - iii. Seller retains legal title / buyer receives equitable title.
  - iv. Buyer makes payments with interest to seller over the life of the contract.
  - v. Seller delivers the deed (legal title) to buyer once all payments have been made.

## 5. Listing / Buyer Representation Contracts

- a. Listing Contract – a contract between an owner (principal) and a licensed real estate brokerage by which the brokerage is employed to list and sell real estate on the owner’s terms within a given time, for which the owner agrees to pay a fee (commission.)
  - i. General requirements of a valid listing contract.
    - 1. Be in writing to be enforceable.
    - 2. State the exact amount of commission to be earned by the broker.
    - 3. Specify a termination date for the agreement.
    - 4. State the price of the real estate and terms of the sale.
    - 5. Include a legal description of the property.
    - 6. Name the Broker.
    - 7. Have (at least) the principal’s signature authorizing the agency and the payment of the commission when earned.
- b. Exclusive Listings
  - i. Exclusive Right-to-Sell
    - 1. One brokerage is given the exclusive right to sell the property.
    - 2. The seller gives up the right to sell the property without paying the broker’s commission.
    - 3. The brokerage receives the commission regardless of who sells the property.
  - ii. Exclusive Agency
    - 1. Only one brokerage is authorized to act as the exclusive agent of the principal.
    - 2. The seller retains the right to sell the property without any obligation to the brokerage.
    - 3. The brokerage receives a commission only if its firm is the procuring cause or caused the sale to happen.
- c. Non-Exclusive Listings
  - i. Open Listing
    - 1. The seller may employ any number of brokerage firms.
    - 2. The seller is obligated to pay a commission only to the brokerage who produces a buyer (procuring cause).
    - 3. If the seller personally sells the property, without the aid of any broker, the seller is not obligated to pay a commission.
  - ii. Net Listing
    - 1. A listing which states a minimum sale or lease price the owner will accept, with any excess going to the broker as a commission.

- a. Illegal in many states.
    - b. Professionally discouraged.
  - d. Buyer Brokerage/Tenant Representation Contracts
    - i. Exclusive Right Contracts
      - 1. Unless agreed that the seller pays the commission, the buyer or tenant must compensate their representative whenever purchasing or renting a property.
        - a. Agreement entered into which describes the type of property sought, and the term of the representation agreement.
          - i. Like a listing contract with a seller.
        - b. Buyer Broker can be compensated in many ways:
          - i. Retainer fee
            - 1. Gives buyer or tenant incentive to perform the contract.
            - 2. The fee may be refundable or nonrefundable.
          - ii. Flat or Fixed Fee
            - 1. The fee can be paid by the buyer or tenant or as a co-op fee by the seller or landlord.
          - iii. Hourly Fee
          - iv. Percentage Fee
            - 1. Can be a percent of sales or rent price or an MLS co-op fee.
- e. Listing Agreements can terminate for:
  - i. Completion of the agreement (Sale of the property)
  - ii. Mutual agreement to terminate the relationship between the parties.
  - iii. Death, incapacity, bankruptcy of Broker/Brokerage or Principal.
  - iv. Expiration of the agreement
  - v. Abandonment by the Broker
  - vi. Condemnation (Eminent Domain) of the Property
  - vii. Destruction of the Property
  - viii. Foreclosure



## Chapter 9 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. For a contract to be enforceable it must be recorded with the recorder's office.
2. An executed contract is one that has yet to be fully performed.
3. There are seven essential elements that makes a valid contract.
4. A valid contract requires all parties to be competent, 18, sane and sober.
5. A valid contract must have mutual consent, also known as meeting of minds; mutual agreement; or offer and acceptance.
6. A valid contract must show consideration, the promise of providing something of value.
7. Consideration can be "of love and affection."
8. Consideration is anything that a willing buyer is willing to give and a willing seller is willing to receive.
9. An essential element of a valid contract is having legal purpose or lawful objective.
10. A listing agreement signed by a licensee and Greta, who lives in the house but isn't on the deed, would still meet the essential element of legal purpose if both parties agree.
11. A valid real estate contract requires the property's legal description.
12. A valid contract must be in writing and signed by all parties to be enforceable in a court of law.
13. The Statute of Frauds states that all real estate contracts (even those that don't transfer ownership) must be in writing to be enforceable.
14. A contract must be notarized, or acknowledged, for it be enforceable.
15. The purpose of the Statute of Frauds is to avoid a "he said, she said" battle.
16. If a contract is missing one or more essential elements, the contract is considered void.

17. A void contract cannot be enforced by a court of law.
18. A voidable contract appears to be valid but there is an injured or disabled party.
19. A party can become injured through duress, fraud, misrepresentation, and being a minor.
20. A property's habitability is one of the essential elements of a valid contract.
21. A valid contract must have a marketable title.
22. The parties to an offer are the offeror and the offeree.
23. The offeror is always the buyer, and the offeree is always the seller.
24. Once under contract, the seller becomes the vendee and the buyer becomes the vendor.
25. During the executory period, the vendor retains legal title and the vendee has equitable title.
26. A counteroffer is a partial rejection of the original offer.
27. A counteroffer is used during the contract's executory period.
28. A vendee's equitable interest prohibits the vendor from selling the property to another party while the contract is in effect.
29. All parties agree to act in good faith to perform the terms of the contract.
30. Lack of adherence to the contract can cause a party to be in default of the agreement.
31. Earnest money is considered actual damages.
32. A real estate contract is a unilateral agreement between a buyer and a seller.
33. An option is a unilateral agreement between a seller and potential buyer.
34. An option is a unilateral contract binding only the potential buyer to purchase the property.
35. An amendment would be used during the executory period.
36. A long legal description is an example of an attachment that would be provided with the offer.

37. Contract obligations are those duties that each party is legally responsible for during the contract period.
38. Contract contingency clauses allow a party the right to terminate a contract under certain circumstances, such as being able to be approved for financing.
39. If a seller defaults on a contract, the buyer's remedy is limited to liquidated damages.
40. A bilateral purchase contract has both a ready, willing and able buyer and a ready, willing and able seller.
41. Real estate contracts are typically express, written agreements.
42. A general expressed contract may either be oral or written.
43. An implied contract is an agreement demonstrated by actions and conduct.
44. An executed contract is a contract that has been fully performed.
45. To modify an executory contract, all parties must agree to and sign an addendum.
46. An offer becomes a contract with communication of acceptance.
47. An offeror is always the buyer, and an offeree is always the seller.
48. An offeror may not withdraw an offer and must wait for a response from the offeree.
49. If an offeree communicates acceptance of an offer prior to the offeror withdrawing, the offer becomes a valid contract.
50. An offer is a unilateral contract until communication of acceptance has been received.
51. A counteroffer is a partial acceptance of the original offer.
52. Death or incapacitation terminates an offer.
53. When a party to a contract fails to perform according to the contract's stipulations, this is considered a breach of contract.
54. If a seller is in breach of contract and defaults, the buyer's remedy may be specific performance.

55. If a seller is in breach of contract and defaults, the buyer may not get their earnest money back upon termination of the contract.
56. If a buyer is in default of the contract, the seller may keep the earnest money as liquidated damages or exercise specific performance, whichever was determined as the seller's remedy at the beginning of the executory period.
57. A contract with a minor to purchase vacant land would be considered to be a void contract.
58. A seller determined insane by a court of law would have a voidable purchase contract with the buyer.
59. Death of the salesperson terminates a listing contract with a seller.
60. A verbal agreement to purchase real estate is an unenforceable contract.
61. An injured party has the right to the rescission of a contract.
62. Electronic signatures are not considered a legal signature and not enforceable in a court of law.
63. An open listing is an example of a bilateral contract.
64. A buyer signs an agency agreement that allows him to find and close on a property without the licensee's assistance and not owe a commission. This is an example of a buyer agency exclusive agency.
65. The statement "time is of the essence" means that a contract deadline allows for a one-time 24-hour extension.
66. If a broker receives multiple offers for a listing, he must show the seller the highest offer before any of the other offers.
67. A buyer submits an offer to a seller stating she will buy his property if she can sell her current property. This is an example of a contingency.
68. No action is needed to satisfy a contingency.
69. An addendum modifies a contract.
70. An amendment modifies a contract.

71. If a party to an offer dies, the offer remains in place.
72. An agent would likely desire a seller to sign an open listing, which limits the amount of competition for the agent to sell the property.
73. A listing agreement would be terminated if the property was condemned.
74. An Exclusive Right to Sell listing contract allows the seller to sell the property without any obligation to the broker.
75. A seller may hire more than one broker to sell his property with a non-exclusive/open listing.
76. A net listing states minimum net proceeds the seller desires, and anything above that amount is the broker's commission.



# 10 Leasing and Property Management

## Basic Concepts / Duties of Property Management Understanding Leases Leasing and the Law

---

### Basic Concepts / Duties of Property Management

---

Property management is a specialty within the real estate profession. Most states require property managers to hold an active real estate license. Property managers generally fall into one of three categories:

- Individual property manager – a real estate broker who manages properties for one or more owners.
- Individual building manager – usually a property manager who manages a single large property.
- Resident manager (residential properties only) – lives on the property and may be employed by a real estate broker to be an on-site manager of the property.

Property managers have a fiduciary relationship with their principal. They are charged with producing the greatest possible net return on the owner's investment while they safeguard the investment's value. They are usually

**general agents** as they bind lease agreements in the name of their principal and perform several activities to accomplish the principal's goals.

Property management services fall into three primary categories:

- Financial
- Physical
- Administrative

The property manager's specific function, duties and responsibilities are outlined in a **management agreement**, which establishes the scope of the owner's responsibilities as well as the manager's. The manager's authority is defined, including hiring, firing and supervision of employees; fixing rental rates; and making expenditures. Usually, expenditures over a certain limit require the owner's written authorization; some, such as capital improvements, may not fall under the manager's purview at all.



Per the agreement, one fundamental responsibility is **financial reporting**. Reports may be required monthly, quarterly, and annually. Examples include an annual operating budget, monthly cash flow reports, expenses, net operating income, net cash flow, and profit and loss statements.

Property managers also develop an **operating budget** for the principal based on expected expenses and revenues. The budget determines rental rates; amounts available for capital expenditures; required funds needed for reserves, salaries and

wages; etc. Budgets should indicate expected returns based on the previous year's performance.

Operating statements itemizing income and expenses should be presented to the owner on a regular basis so the owner can evaluate the manager's performance against the budget. Items that would be reported to the owner might be the total of scheduled rents plus revenues from other sources (vending machines, laundry, etc.); fixed expenses that remain constant and

may include operating expenses, regular maintenance costs and administration; variable expenses that may change from month to month or occur sporadically; capital expenditures for major items like renovations or major repairs; and cash reserves, which is a fund set aside from operating revenues for variable expenses such as supplies, redecorating, and repairs.

Lastly, the property manager's responsibilities include seeing that the property is properly rented. Another reason why they are general agents, property managers will perform the following tasks:

- Controlling vacancies – high tenant turnover adds to increased advertising and redecorating expenses.
- Marketing and advertising the property.
- Establishing and setting rents.
- Selecting and screening tenants.
- Collecting rents.
- Maintaining tenant relations.
- Maintaining the real property.
- Safeguarding and handling security deposits.
- Managing risk by verifying that the property is adequately insured as well as safe for tenants and guests.

Because **security deposits** are intended to be returned to the tenant at the end of the lease, that money actually belongs to the tenant and not the landlord. Such deposits need to be placed in escrow or trust accounts separate from the property manager's operating accounts.

Rental income must be sufficient to cover fixed and operating expenses yet still provide the landlord a desired return on investment. **Rental rates** must be realistic, taking what is happening in the market into account. The property manager must consider prevailing rents in comparable properties as well as vacancy rates in the market and in the property.

The manager conducts a detailed survey of competitive space and makes adjustments for differences between the subject property and competing properties before setting the rental rates. It would be unrealistic to expect a zero **vacancy rate**, where every unit in a building is occupied by a tenant 100% of the time. However, if vacancy rates in the managed property are too high, rents may have to be lowered or problems in the property or management must be identified that contribute to the vacancy level. If the

vacancy rate is significantly lower than the market, rental rates may need to be raised to coincide with current conditions.

Physical maintenance of the property is one of the property manager's primary functions and includes routine, preventive, and corrective measures. **Routine maintenance** activities cover the day-to-day functioning of the property and include regular inspections, scheduled upkeep of mechanical systems like heating and air-conditioning, and minor repairs. **Preventive maintenance** goes beyond the routine in attempting to deal with situations that can become serious problems if ignored. Lastly, **corrective maintenance** is needed when routine and preventive maintenance fail; repairs and replacements become mandatory to keep the property operational.

---

## Understanding Leases

---

### *Leasehold Estates*

Where freehold estates describe ownership interests in real property, **leasehold estates** or **non-freehold estates** are non-possessory interests that reflect a tenant's right to occupy the premises. The parties here are the **lessor** (landlord) and the **lessee** (tenant). Lessors have given up the rights of possession and use to their tenants and now have a **leased fee estate**. A lessor has a **reversion** interest in a property rented to a lessee; when the lease is up, the rights of possession and use revert to the lessor. Leasehold estates are also referred to as **tenancies**.

## TYPES OF LEASES

ESTATE FOR YEARS (TENANCY FOR YEARS)	PERIOD TO PERIOD (PERIODIC TENANCY)	ESTATE AT WILL (TENANCY AT WILL)	ESTATE AT SUFFERANCE
<p>Known first and last days. Has a definite termination date.</p> <p>Lessee must vacate the premises when the estate expires.</p> <p>Death of either party does not terminate the lease.</p>	<p>Has no definite ending date.</p> <p>Automatically renews period upon payment and acceptance of rent.</p> <p>Can be for any term (day, week, month, quarter, year, etc.)</p> <p>Notice requirements to terminate lease.</p>	<p>Tenant has consent of the landlord to possess property as long as the tenant wants.</p> <p>No renewal cycle and definite termination date.</p> <p>Notice requirements to terminate lease.</p> <p>Death of either party terminates the lease.</p>	<p>A tenancy against the landlord's will and without an agreement.</p> <p>Usually exists when a tenant stays beyond the expiration of a lease without landlord's permission.</p> <p>May require an eviction procedure.</p>

**Estate for years or tenancy for years** is defined as an interest granted with known first and last days (the tenancy has a definite termination date). The duration can be one day or twelve years; the “years” part doesn’t reflect the occupation period. The lessee must vacate the premises when the estate expires, relinquishing his or her right to occupy. Most commercial leases grant this type of estate. Death of either party does not terminate the lease.

Often used for residential properties, an **estate from period to period (periodic tenancy)** has no definite ending date. Rather, it automatically renews for successive periods upon payment and acceptance of rent until one party gives notice to terminate. The most common form is month-to-month, but this tenancy can automatically renew every quarter or every year. In effect, as long as the rent is paid when due and the landlord accepts the rent check, the lease automatically renews. Death does not terminate this lease.

If a tenant has the right to possess a property with the consent of the landlord for as long as the tenant wants, we call this **estate at will (tenancy at will)**. There’s no automatic renewal cycle and no definite termination date, however this tenancy can be cancelled with proper notice. Tenancy at will is similar to periodic tenancy, except that it does not have a defined period. It continues with the consent of the lessor if the tenant pays rent at regular intervals. Let’s say your cousin is moving to town and needs a place to stay while looking for a job and a place of her own. You offer your finished basement and tell her to stay as long as she likes. You’ve established a

tenancy at will. This tenancy is terminated by the death of either party. It is rarely, if ever, used in a written lease.

Lastly, **estate at sufferance** describes a tenancy against the landlord's will and without an agreement. It exists when a tenant stays beyond the expiration of another type of lease *without the lessor's permission*. For example, Joe has a periodic tenancy agreement where he pays \$1,000 on the first of every month to stay in an apartment over Ed's garage. Joe refuses to pay the rent, therefore terminating the periodic tenancy. Joe also refuses to leave the apartment. He has created an estate at sufferance where Ed is suffering.

## *Lease Types*

Numerous types of leases can be negotiated between the lessee and lessor. A **gross lease**, which is often used in residential situations, requires the tenant to pay an established, fixed rent and the landlord pays all property operating expenses, such as taxes, insurance, utilities, and other services. A **net lease**, on the other hand, has the tenant paying rent plus some or all of the operating expenses attributable to the rented space. A Single Net (N) lease requires the lessee to pay rent plus property taxes; a Double Net (NN) covers rent, property taxes and property insurance; and a Triple Net (NNN) includes rent, property taxes, property insurance and maintenance. (Hall, 2023) This lease type is more common with office and industrial leases.

Usually found in retail leases, a **percentage lease** may be a gross lease or a net lease, but the rent is not fixed. Instead, rent depends on the income generated by the leased property, which may be a base rent or a portion of the tenant's sales income, usually whichever is more. Consider a large chain store that offers space to other small businesses within its walls, like a bank, a coffee shop or a nail salon. Those small businesses that are not income-generating, such as the bank, would probably be offered a net lease, while the coffee shop or nail salon would probably pay a rent equivalent to a percentage of the revenue the business generated that month.

## LEASES BASED ON RENT

Gross Lease	A fixed rental rate
Net Lease	A fixed rental rate + some/all operating expenses
Percentage	A fixed rental rate + percentage of the property's profits

In some situations, an owner may wish to sell his property but retain the right to occupy for a defined period of time. This is common in low-inventory markets where homeowners may end up quickly selling their home but find it difficult to locate and/or contract on their next property. In this situation, a **sale leaseback** allows the homeowner to close on the sale of their property but remain as a tenant, owing rent and/or a security deposit to the purchaser, who is now a landlord.

Lastly, a **ground lease** or **land lease** allows an owner to grant a tenant a leasehold interest in land only in exchange for rent. Land leases are often utilized for agricultural or mining operations and are usually very long-term leases ranging from 30 to 50 years. If a tenant builds an improvement on vacant land with a ground lease, at the end of the lease term, the improvement becomes the landlord's property.

### *Key Lease Elements and Provisions*

A written lease agreement contains common key elements and provisions that protect the landlord as well as the tenant. Here are common examples:

- Rental amount.
- Security deposit amount, where it will be held, and how it can be returned. Security deposits cannot be withheld for normal wear and tear.
- The start and end date of the lease (lease term).

- The landlord's and the tenant's respective responsibilities for property repairs and upkeep.
- Whether the tenant can sublet (**sublease**) or assign (**assignment**) their lease interest to another individual with or without the landlord's approval.

Subleasing is the transfer by the tenant of all or part of the interest in the lease to another party, through a sublease. The sublessor (original tenant) remains primarily liable, and liable for all payments, for the original lease with the landlord.

An assignment of the lease is a transfer of the entire leasehold interest by a tenant to a third party. This new party who has been assigned the lease becomes liable for making payments to the landlord. The original tenant is no longer responsible for making lease payments but may retain some liability for the non-performance of the new assignee.

- Rules and regulations the tenant must abide by, including usage restrictions.
- What, if any, alterations the tenant can make and who owns any improvements made to the property by the tenant. Improvements usually belong to the landlord, even if installed by the tenant.
- Defines and clarifies if the tenant has any opportunity to choose a course of action at some time in the future under certain terms, i.e., an option to purchase the property (rent-to-own).
- The rights and obligations of the parties if the leased premises are damaged or destroyed.
- Signatures indicating acceptance.

*A lease for one year or less does not need to be in writing to be enforceable under the Statute of Frauds.*

## ***Landlord and Tenant Rights and Obligations***

Leases also specify the rights and responsibilities of each party. Landlords retain a right of entry into the premises to perform needed repairs and

maintenance. The lease and/or the law may specify that a landlord may enter the tenant's property only under one or more of the following conditions:

- An emergency requires the landlord to enter.
- The tenant gives consent to enter.
- The landlord enters during normal business hours and only after giving notice to either make repairs or to show the property to prospective tenants, purchasers or contractors.
- The tenant has abandoned or surrendered the property.
- The landlord has a court order allowing entry.

The landlord has the right to receive prompt payment of rent and to expect the tenant to adhere to stated rules. At the end of the term, the landlord has the right to retake possession of the premises. If a tenant is in breach of his or her lease, the landlord has the right to pursue eviction to retake possession. **Actual eviction** follows a procedure prescribed in state law and stated in the lease contract. The landlord must serve notice on the tenant a specified number of days before beginning the eviction suit. A court issues a judgment for possession, which requires the tenant to vacate. A court officer, such as a sheriff, may forcibly remove the tenant and possessions if the tenant refuses to vacate. The landlord can then enter and take possession.



In addition, the landlord is expected to deliver a property that is **habitable**. The landlord should at the very least keep the heating, cooling, electrical, and plumbing systems in good working condition; keep floors, stairways and railings safe and in good repair; provide pest control as needed; and repair roof leaks and broken windows promptly.

The tenant has the right to quiet enjoyment or to enjoy the property without worry that the landlord will access it without permission. The tenant has the right to a habitable residence/building. If the landlord doesn't perform under the terms of the lease, the tenant may have the right to move out without liability for back

rent or the unexpired portion of the lease (called **constructive eviction**), or refer the problem to mediation, arbitration or to small claims court.

Unless otherwise established by state law, the tenant is responsible for

- Paying rent on time.
- Following the rules and regulations set by the landlord.
- Giving a 30-day notice when terminating a month-to-month lease.
- Returning all door and mailbox keys when leaving the property.
- Leaving the unit in the condition it was at the start of the lease.
- Keeping the unit clean and sanitary.
- Disposing of all trash and other waste in a sanitary manner.
- Using and operating all fixtures correctly and safely.
- Refraining from damaging or destroying the property.
- Preventing others from destroying the property.
- Using the property only for its intended purposes.

---

## Leasing and the Law

---

Property managers have a duty to ensure that their clients (property owners) comply with all applicable laws, and therefore must know several key federal legislative acts. For example, the **Americans with Disabilities Act (ADA) Title I** provides that any employer of 15 or more employees must adopt nondiscriminatory employment procedures. Additionally, employers must make reasonable accommodations to enable an individual with a disability to perform his or her essential job functions.

Property managers must be familiar with **ADA Title III**, which prohibits discrimination in commercial properties and public accommodations. This law requires that people with disabilities have full and equal access to facilities and services. Owners of existing structures are protected from paying for extensive remodeling; however, the ADA still requires **reasonably achievable accommodations** to be made to provide access to the facilities or services.

New construction and remodeling *must* meet higher standards of accessibility and usability. It costs less to incorporate accessibility features in the design than to retrofit after the fact. A property manager must determine whether a building meets ADA accessibility requirements and may need to prepare a plan for retrofitting a building that does not. He or she needs to determine when removal of existing barriers is achievable and can be performed without much difficulty or expense.

The following are typical examples of reasonably achievable modifications:

- Installing ramps or removing obstacles from an otherwise accessible entrance
- Adding grab bars to public restroom stalls
- Providing raised letters and Braille markings on elevator buttons
- Installing auditory signals in elevators
- Providing doors with automatic opening mechanisms

The **Equal Credit Opportunity Act** requires that property managers use the same lease application for every applicant and implement consistent procedures, including how they evaluate applicants' income and debt, as well as determine whether to rent to an applicant. The act protects against discrimination for tenant age and those receiving public assistance.

Property managers must also understand the **Fair Housing Act**, which prohibits discrimination in housing sales, rental, or financing based on race, color, religion, national origin, sex, familial status, or disability. For example, it would be a violation of Fair Housing law for property managers or owners to assign one building in an apartment complex as "families only" to provide quieter housing for single tenants, as this discriminates against families. New tenant advertising activities must not violate fair housing laws. Additionally, because disability is a protected class, tenants who wish to make accessibility modifications to their rental unit cannot be refused permission to do so, however the cost is on the tenant and the tenant may be required to return the property to its original condition at the end of the lease. A manager has the right to refuse to rent to a person who has a history of paying rent late, damaging property, fighting with other tenants, or has spotty employment.



# Chapter 10 Key Point Review

---

1. Basic Concepts / Duties of Property Management.
  - a. Property management is a specialty within the real estate profession.
    - i. Most states require property managers to hold an active real estate license.
    - ii. Property managers generally fall into one of three categories:
      1. Individual property manager – a real estate broker that manages properties for one or more owners.
      2. Individual building manager – usually a property manager that manages a single large property.
      3. Resident manager (residential properties only) – lives on the property and may be employed by a real estate broker to be an on-site manager of the property.
    - iii. Property managers have a fiduciary relationship with their principal.
      1. Charged with producing the greatest possible net return on the owner's investment while they safeguard the value of the investment for the owner/investor.
      2. Property managers are usually general agents as they bind lease agreements in the name of their principal (a limited agent could not do that.)
  - b. Property management services fall into three primary categories:
    - i. Financial
    - ii. Physical
    - iii. Administrative
  - c. Specific function, duties and responsibilities are determined by the management agreement.
  - d. Property management agreements will usually include the following items.
    - i. Reporting – Financial reporting to the principal is a fundamental responsibility of the property manager.
      1. Reports may be required monthly, quarterly, and annually.
      2. Annual operating budget, monthly cash flow reports, expenses, net operating income, net cash flow, profit and loss statements are a sample of some of the reports that may be required.

ii. Budgeting – An operating budget based on expected expenses and revenues is a necessity for management.

1. The budget determines rental rates, amounts available for capital expenditures, required funds needed for reserves, salaries and wages, etc.
2. Budgets should indicate expected returns based on the previous year's performance.
3. Operating statements itemizing income and expenses should be presented to the owner on a regular basis so that the owner can evaluate the manager's performance against the budget.
4. Items that would be reported to the owner might be:
  - a. Income – the total of scheduled rents plus revenues from other sources (vending machines, laundry, etc.)
  - b. Expenses – may be fixed or variable.
    - i. Fixed expenses are those that remain constant and may include operating expenses, regular maintenance costs and administration.
    - ii. Variable expenses are those that may change from month to month or occur sporadically.
  - c. Capital Expenditures – expenditures for major items (renovations, major repairs) should be included as a budgeting item.
  - d. Cash Reserve – a cash reserve is a fund set aside from operating revenues for variable expenses such as supplies, redecorating, and repairs.

iii. Renting

1. The property manager's responsibilities include seeing that the property is properly rented. They will need to perform the following tasks:
  - a. Controlling vacancies – successful managers look for factors that may affect vacancies and must take steps to limit or counteract them.
  - b. Marketing and Advertising the Property
  - c. Establish and set rents
  - d. Select and screen tenants
  - e. Collect rents
  - f. Maintain tenant relations

- g. Maintain the real property
- h. Safeguard and handle Security Deposits (held in a separate account from property owners operating account.)
- i. Verify that the property is adequately covered by insurance.

## 2. Understanding Leases

### a. Types of Leases

#### i. Estate for Years

1. An estate for years may be for any definite period (years, months, weeks, days). When the estate expires, the lessee must return the premises to the lessor and vacate the premises. Most commercial leases grant this type of estate. (Death of either party does not terminate the lease.)

#### ii. Periodic Tenancy

1. An estate from period-to-period does not have any definite period.
  - a. Begins as a lease for a definite period but continues after the expiration of the lease.
  - b. As long as the lessee continues to pay rent at a regular interval, the lessor accepts it, and no one gives notice to terminate the leases the lease from period-to-period continues. (Death does not terminate.)
  - c. Very common with residential properties.

#### iii. Tenancy at Will

1. A tenancy at will is similar to the periodic tenancy, except that it does not begin with a definite period.
  - a. Continues with the consent of the lessor, as long as the tenant pays rent at regular intervals.
  - b. Terminated by the death of either party.
  - c. Rarely, if ever, used in a written lease.

#### iv. Tenancy at Sufferance

1. A tenancy or estate at sufferance comes into existence when a tenant stays beyond the expiration of another type of lease without the lessor's permission.

- v. Gross lease
    - 1. Tenant pays an established, fixed rent, and the landlord pays all property operating expenses, such as taxes, insurance, utilities, and other services.
      - a. Usually found in residential leases.
  - vi. Net lease
    - 1. Tenant pays rent plus some or all of the operating expenses attributable to the rented space.
      - a. Usually found in office and industrial leases.
  - vii. Percentage lease
    - 1. A percentage lease may be a gross lease or a net lease, but the rent is not fixed.
      - a. Rent depends on the income generated by the tenant in the leased property.
      - b. Usually found in retail leases.
  - viii. Ground lease (land lease)
    - 1. An owner grants a tenant a leasehold interest in land only, in exchange for rent.
      - a. Utilized for agricultural or mining operations.
      - b. Usually very long-term leases ranging from 30 to 50 years.
- b. Key elements and provisions of lease agreements
- i. Rent – defines the lease rent amount
  - ii. Security deposit – defines the amount of security deposit, where it will be held and how it can be returned. Cannot be withheld for normal wear and tear.
  - iii. Lease term – the start and end date of the lease.
  - iv. Repairs and maintenance – defines the landlord’s and the tenant’s respective responsibilities for property repairs and maintenance.
  - v. Subletting and assignment – defines whether the tenant can sublet or assign their lease interest to another individual with or without the landlord’s approval.
  - vi. Rules and regulations – the tenant will be obligated to abide by all usage restrictions imposed by the lease’s rules and regulations for the property.
  - vii. Improvements and alterations – defines what, if any, alterations the tenant is allowed to do. Also, will define who owns any improvements made to the property by the tenant.

1. Improvements usually belong to the landlord, even if installed by the tenant.
- viii. Options – defines and clarifies if the tenant has any opportunity to choose a course of action at some time in the future under certain terms.
  1. (i.e. – an option to purchase the property they are renting.)
- ix. Damage and destruction – defines the rights and obligations of the parties in the event, if the leased premises are damaged or destroyed.
- x. Signatures – Indicating acceptance.
  1. Remember a lease for less than one year does not need to be in writing to be enforceable under the Statute of Frauds.

### 3. Landlord (Lessor) rights and responsibilities

#### a. Rights

- i. Retains a right of entry into the premises in order to perform needed repairs and maintenance on a property.
  1. The lease and/or the law may specify that a landlord may enter the tenant's property only under one or more of the following conditions.
    - a. An emergency requires the landlord to enter.
    - b. The tenant gives consent to enter.
    - c. The landlord enters during normal business hours and only after giving notice to either make repairs or to show the property to prospective tenants, purchaser or contractors.
    - d. The tenant has abandoned or surrendered the property.
    - e. The landlord has a court order allowing the entry.
- ii. Landlord has the right to receive prompt payment of rent.
- iii. Landlord has the right to expect the tenant to adhere to building rules.
- iv. At the end of the term the landlord has the right to retake possession of the premises.
- v. In the case of a tenant breach the landlord has the right to pursue eviction to retake possession.

#### b. Responsibilities

- i. Landlord is expected to deliver a property that is habitable. The landlord should at the very least:
  1. Keep the heating, cooling, electrical, and plumbing systems in good working condition.

2. Keep floors, stairways and railing safe and in good repair.
3. Provide pest control as needed.
4. Repair roof leaks and broken windows promptly.

#### 4. Tenant (Lessee) rights and responsibilities

##### a. Rights

- i. Tenant has the right to quiet enjoyment (talked about above).
- ii. Tenant has the right to a habitable residence/building.
- iii. Tenant may have other rights if landlord doesn't perform under the terms of the lease such as:
  1. Moving out without liability for back rent or the unexpired portion of the lease (constructive eviction.)
  2. Referring the problem to mediation, arbitration or small claims court.

##### b. Responsibilities

- i. Pay rent on time
- ii. Follow the rules and regulations set by the landlord.
- iii. Give a 30-day notice when terminating a month-to-month lease.
- iv. Return all door and mailbox keys when leaving the property.
- v. Leave the unit in as clean a condition as it was at the start of the lease.
- vi. Keep the unit clean and sanitary.
- vii. Dispose of all trash and other waste in a sanitary manner.
- viii. Use and operate all fixtures correctly and safely.
- ix. Refrain from damaging or destroying the property.
- x. Prevent others from destroying the property.
- xi. Use the property only for its intended purposes.

#### 5. Leasing and the Law

##### a. Americans with Disabilities Act (ADA)

- i. ADA Title 1 provides that any employer of 15 or more employees must adopt nondiscriminatory employment procedures.
  1. Employers must make reasonable accommodations to enable an individual with a disability to perform essential job functions.
- ii. Property managers must be familiar with ADA Title III
  1. Prohibits discrimination in commercial properties and public accommodations.

- a. Requires that people with disabilities have full and equal access to facilities and services.
  - iii. Owners of existing structures are protected from the expense of extensive remodeling.
    - 1. The ADA still requires reasonably achievable accommodations to provide access to the facilities or services.
  - iv. New construction and remodeling **MUST** meet higher standards of accessibility and usability.
    - 1. It costs less to incorporate accessible features in the design than to retrofit.
  - v. A property manager is responsible for determining whether a building meets ADA accessibility requirements.
    - 1. Property managers may need to prepare a plan for retrofitting a building that is not in compliance when removal of existing barriers is achievable and can be performed without much difficulty or expense.
    - 2. The following are typical examples of readily achievable modifications:
      - a. Ramping or removing an obstacle from an otherwise accessible entrance.
      - b. Lowering wall-mounted public telephones.
      - c. Adding raised letters and Braille markings on elevator buttons.
      - d. Installing auditory signals in elevators.
      - e. Reversing the direction in which doors open.
- b. Equal Credit Opportunity Act
- i. Prohibits lenders from denying a loan based on a person's race, color, religion, national origin, sex, marital status, age, or receipt of public assistance.
  - ii. ECOA also affects property managers.
    - 1. Managers should use the same lease application for every applicant.
    - 2. If a manager requests a credit report from one applicant, they should require a credit report from all applicants.
    - 3. The manager should be consistent in evaluating the income and debt of applicants, and in determining whether to rent to an applicant.



## Chapter 10 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. A property manager is required to hold an active real estate license.
2. A property manager is a limited/special agent for the property owner.
3. One of the goals of the property manager is to find well-qualified tenants on behalf of the property owner.
4. One of the goals of the property manager is to maintain the value of the property on behalf of the property owner.
5. A property manager is allowed to make capital improvements on a property on behalf of the property owner.
6. As a general agent, a property manager is responsible for financial, physical and administrative services for the principal.
7. A property management agreement is the contract used to hire the property manager to be the general agent for the principal/property owner.
8. Providing financial reports and creating a budget for a leased property is not a responsibility of the property manager.
9. Checking a prospective tenant's credit report and criminal background are two of the tasks a property manager would do to find a well-qualified tenant for the property owner.
10. A property manager may use the broker's operating account to hold rents and security deposits.
11. If a property manager notices the rental vacancy rates are lower than market rates, s/he should consider lowering the rental rates.
12. High tenant turnover rates decrease marketing expenses and increases profits.
13. A leasehold estate is also known as a non-freehold estate.
14. A non-freehold estate shows proof of ownership.

15. A non-freehold estate shows proof of possession.
16. An estate for years is also known as a tenancy for years and has an expiration/termination date.
17. An estate for years can only be used with residential leases.
18. A month-to-month lease is an example of an estate for years.
19. A periodic estate shows proof of ownership for a defined period of time.
20. A periodic estate is also known as a periodic tenancy or tenancy from period to period.
21. If a lessee continues to make their periodic payments and the lessor accepts it, the periodic tenancy continues.
22. Estate from period to period is common with residential properties.
23. There is a definite termination date with a periodic tenancy.
24. Death will terminate a tenancy for years.
25. Death will terminate an estate from period to period.
26. Death will terminate an estate at will.
27. A lessor is the tenant, and a lessee is the landlord.
28. Lessors have leasehold interests in a rental property while lessees have a reversionary interest.
29. Lessees have the right of possession and use in real property in exchange for payment of rent.
30. A tenancy at will can be an oral lease agreement.
31. An estate at sufferance is when the lessee has not vacated the property per the lease agreement and continues to have possession of the property beyond the termination/expiration date.
32. In a gross lease, the tenant pays a fixed rate and the property owner is responsible to pay all property operating expenses.

33. A gross lease is typically found in commercial properties.
34. A net lease requires a tenant to pay a base rent plus a percentage of the operating expenses.
35. A percentage lease requires a tenant to pay a base rent or a portion of their sales income, usually whichever is more.
36. A percentage lease is typically found in retail leases.
37. A ground lease is also known as a land lease.
38. A business owner may want to sell his real estate but continue his right of possession by using a sale leaseback which allows him to raise capital and reduce his business debt.
39. If a tenant builds an improvement on vacant land with a ground lease, at the end of the lease term, the improvement becomes the landlord's property.
40. Rent belongs to the lessor, while security deposits belong to the lessee.
41. A lease option is the same as an option.
42. A lease option can also be known as a rent to own.
43. A landlord gives up his right of possession in exchange for rent and has a leased fee estate.
44. A lessor has a reversion interest in a property rented to a lessee.
45. A lessor may retain the right to enter his leased property for repairs and/or maintenance with notice and consent from the lessee.
46. A landlord is expected to keep a leased property in habitable condition in exchange for rent.
47. If a lessee has violated their lease agreement, a lessor can exercise constructive eviction.
48. If a lessor fails to keep a leased property in habitable condition, the lessee can exercise constructive eviction, but must vacate the property.
49. Tenant abandonment of a property terminates an existing lease.
50. Security deposits can be withheld for normal wear and tear once the tenant vacates the property.

51. A landlord must allow a disabled tenant to make appropriate modification per Feder Fair Housing laws.
52. A disabled tenant who makes modifications to a leased property may be asked to pay for the costs to reverse those modifications.
53. A landlord must pay for the modification to a leased property on behalf of a disabled tenant.
54. The Americans with Disabilities Act (ADA) prohibits discrimination in commercial properties.
55. ADA ensures that the disabled have equal access to public accommodations.
56. ADA requires accessibility to accommodations be readily achievable to existing properties.
57. New construction must meet higher standards for public accommodations when being built than existing properties.
58. Adding a ramp to an entrance with stairs is an example of making a readily achievable modification.
59. The Equal Credit Opportunity Act (ECOA) allows lenders to discriminate against age and those receiving public assistance.
60. ECOA protects against the same classifications as Federal Fair Housing.

# 11

## Closing a Real Estate Transaction

### Escrow or Closing Trust/Escrow Accounts Dollars and Cents

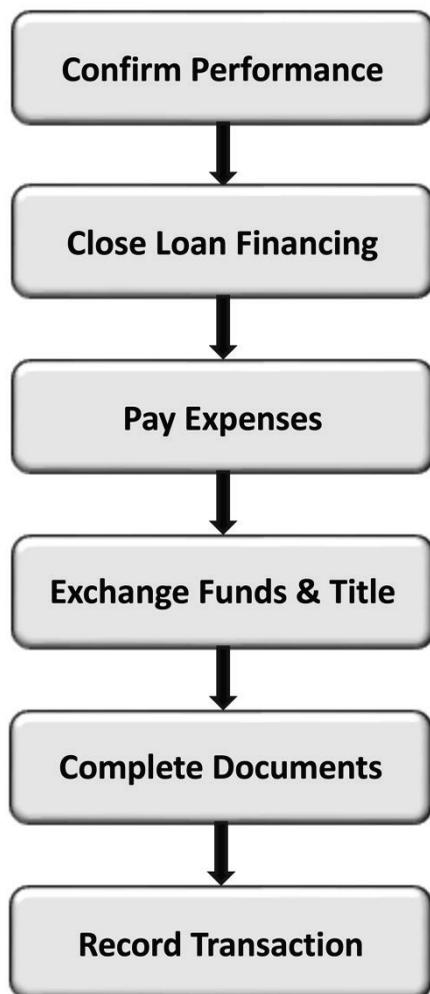
---

### Escrow or Closing

---

Once all the contingencies in a purchase contract have been met, the transaction can be finalized or closed. In some states, real estate closings are handled by attorneys. In others, title companies can be hired to not only provide title insurance, but to close a real estate transaction. In many states, the listing brokerage firm has overall responsibility for the closing and could be the closing agent.

The primary parties at a real estate closing are the sellers, buyers, licensees, and a **closing agent** or escrow officer. The process starts with verifying that all of the contract terms and contingencies have been met, i.e., the contract has been performed. If the buyer used a loan to purchase the property, the loan paperwork must be signed by the buyer and the loan closed. All expenses are then determined, apportioned, and paid. The buyer pays for the property and title is transferred into the buyer's name, final documents are signed, and the new deed is sent to be recorded with the county clerk and recorder or another appropriate governmental office.



Some states close real estate transactions “in escrow” rather than face-to-face or at a closing table where all parties are present. An escrow agent collects documents and manages the transaction, dispersing funds and releasing the title once all conditions have been met.

Escrow or closing agents are a neutral third party authorized to coordinate the closing activities of a real estate transaction. Their responsibilities include:

- Holding financial documents in trust.
- Gathering required legal documents.
- Ordering an examination on the property.
- Preparing specific closing instructions.
- Gathering documents from the buyer’s lender.
- Ensuring that all terms of the offer to purchase have been completed.
- Recording any necessary documents, such as the deed.

If there are any encumbrances or liens that affect the title, the seller is expected to remove these prior to the date specified in the contract. The most common title cloud is an unpaid lien. The buyer should inspect the property (called a **walkthrough**) to make certain that

the property is in the condition in which the seller states that it is, and that any repairs or other required actions have been performed. Additionally, If the seller's mortgage lien(s) are to be satisfied at closing, the lender will provide a **payoff statement** specifying the amount of unpaid principal and any interest due as of the closing date, plus fees that will be due the lender and any credits or penalties that may apply.

## ***RESPA / TRID /DISCLSOURES***

The buyer's lender is federally required to provide a disclosure to the buyer before closing thanks to the **TILA – RESPA Integrated Disclosure (TRID) rule**, which became effective on October 3, 2015. The rule requires the use of new integrated disclosure forms for consumers at the time of application (**Loan Estimate**) and Settlement (**Closing Disclosure**). The Loan Estimate provides estimates on items such as loan origination fee, loan application fee, appraisal fee, credit report and property taxes from the day of closing to the end of the tax year. It must be placed in the mail or delivered to the buyer no later than the third business day after receiving their application. The buyer must receive the Closing Disclosure at least three business days prior to closing. This document is a more accurate determination of these fees but can only deviate from the Loan Estimate within certain tolerances. Saturday is considered a business day for the Closing Disclosure.

A sample of the Closing Disclosure is reprinted on the following pages.

# Closing Disclosure

This form is a statement of final loan terms and closing costs. Compare this document with your Loan Estimate.

Closing Information		Transaction Information		Loan Information	
<b>Date Issued</b>	4/15/2013	<b>Borrower</b>	Michael Jones and Mary Stone 123 Anywhere Street Anytown, ST 12345	<b>Loan Term</b>	30 years
<b>Closing Date</b>	4/15/2013	<b>Seller</b>	Steve Cole and Amy Doe 321 Somewhere Drive Anytown, ST 12345	<b>Purpose</b>	Purchase
<b>Disbursement Date</b>	4/15/2013	<b>Lender</b>	Ficus Bank	<b>Product</b>	Fixed Rate
<b>Settlement Agent</b>	Epsilon Title Co.			<b>Loan Type</b>	<input checked="" type="checkbox"/> Conventional <input type="checkbox"/> FHA <input type="checkbox"/> VA <input type="checkbox"/>
<b>File #</b>	12-3456			<b>Loan ID #</b>	123456789
<b>Property</b>	456 Somewhere Ave Anytown, ST 12345			<b>MIC #</b>	000654321
<b>Sale Price</b>	\$180,000				

Loan Terms	Can this amount increase after closing?	
<b>Loan Amount</b>	\$162,000	<b>NO</b>
<b>Interest Rate</b>	3.875%	<b>NO</b>
<b>Monthly Principal &amp; Interest</b> <i>See Projected Payments below for your Estimated Total Monthly Payment</i>	\$761.78	<b>NO</b>
	<b>Does the loan have these features?</b>	
<b>Prepayment Penalty</b>	<b>YES</b>	• As high as \$3,240 if you pay off the loan during the first 2 years
<b>Balloon Payment</b>	<b>NO</b>	

Projected Payments		
Payment Calculation	Years 1-7	Years 8-30
Principal & Interest	\$761.78	\$761.78
Mortgage Insurance	+ 82.35	+ —
Estimated Escrow <i>Amount can increase over time</i>	+ 206.13	+ 206.13
<b>Estimated Total Monthly Payment</b>	<b>\$1,050.26</b>	<b>\$967.91</b>
<b>Estimated Taxes, Insurance &amp; Assessments</b> <i>Amount can increase over time See page 4 for details</i>	\$356.13 a month	<b>This estimate includes</b> <input checked="" type="checkbox"/> Property Taxes <input checked="" type="checkbox"/> Homeowner's Insurance <input checked="" type="checkbox"/> Other: Homeowner's Association Dues <i>See Escrow Account on page 4 for details. You must pay for other property costs separately.</i>
		<b>In escrow?</b> <b>YES</b> <b>YES</b> <b>NO</b>

Costs at Closing	
<b>Closing Costs</b>	\$9,712.10 Includes \$4,694.05 in Loan Costs + \$5,018.05 in Other Costs – \$0 in Lender Credits. See page 2 for details.
<b>Cash to Close</b>	\$14,147.26 Includes Closing Costs. See Calculating Cash to Close on page 3 for details.

## Closing Cost Details

Loan Costs	Borrower-Paid		Seller-Paid		Paid by Others
	At Closing	Before Closing	At Closing	Before Closing	
<b>A. Origination Charges</b>	<b>\$1,802.00</b>				
01 0.25 % of Loan Amount (Points)	\$405.00				
02 Application Fee	\$300.00				
03 Underwriting Fee	\$1,097.00				
04					
05					
06					
07					
08					
<b>B. Services Borrower Did Not Shop For</b>	<b>\$236.55</b>				
01 Appraisal Fee to John Smith Appraisers Inc.					\$405.00
02 Credit Report Fee to Information Inc.		\$29.80			
03 Flood Determination Fee to Info Co.	\$20.00				
04 Flood Monitoring Fee to Info Co.	\$31.75				
05 Tax Monitoring Fee to Info Co.	\$75.00				
06 Tax Status Research Fee to Info Co.	\$80.00				
07					
08					
09					
10					
<b>C. Services Borrower Did Shop For</b>	<b>\$2,655.50</b>				
01 Pest Inspection Fee to Pests Co.	\$120.50				
02 Survey Fee to Surveys Co.	\$85.00				
03 Title – Insurance Binder to Epsilon Title Co.	\$650.00				
04 Title – Lender's Title Insurance to Epsilon Title Co.	\$500.00				
05 Title – Settlement Agent Fee to Epsilon Title Co.	\$500.00				
06 Title – Title Search to Epsilon Title Co.	\$800.00				
07					
08					
<b>D. TOTAL LOAN COSTS (Borrower-Paid)</b>	<b>\$4,694.05</b>				
Loan Costs Subtotals (A + B + C)	\$4,664.25	\$29.80			
<b>Other Costs</b>					
<b>E. Taxes and Other Government Fees</b>	<b>\$85.00</b>				
01 Recording Fees Deed: \$40.00 Mortgage: \$45.00	\$85.00				
02 Transfer Tax to Any State			\$950.00		
<b>F. Prepays</b>	<b>\$2,120.80</b>				
01 Homeowner's Insurance Premium ( 12 mo.) to Insurance Co.	\$1,209.96				
02 Mortgage Insurance Premium ( mo.)					
03 Prepaid Interest ( \$17.44 per day from 4/15/13 to 5/1/13 )	\$279.04				
04 Property Taxes ( 6 mo.) to Any County USA	\$631.80				
05					
<b>G. Initial Escrow Payment at Closing</b>	<b>\$412.25</b>				
01 Homeowner's Insurance \$100.83 per month for 2 mo.	\$201.66				
02 Mortgage Insurance per month for mo.					
03 Property Taxes \$105.30 per month for 2 mo.	\$210.60				
04					
05					
06					
07					
08 Aggregate Adjustment	- 0.01				
<b>H. Other</b>	<b>\$2,400.00</b>				
01 HOA Capital Contribution to HOA Acre Inc.	\$500.00				
02 HOA Processing Fee to HOA Acre Inc.	\$150.00				
03 Home Inspection Fee to Engineers Inc.	\$750.00			\$750.00	
04 Home Warranty Fee to XYZ Warranty Inc.			\$450.00		
05 Real Estate Commission to Alpha Real Estate Broker			\$5,700.00		
06 Real Estate Commission to Omega Real Estate Broker			\$5,700.00		
07 Title – Owner's Title Insurance (optional) to Epsilon Title Co.	\$1,000.00				
08					
<b>I. TOTAL OTHER COSTS (Borrower-Paid)</b>	<b>\$5,018.05</b>				
Other Costs Subtotals (E + F + G + H)	\$5,018.05				
<b>J. TOTAL CLOSING COSTS (Borrower-Paid)</b>	<b>\$9,712.10</b>				
Closing Costs Subtotals (D + I)	\$9,682.30	\$29.80	\$12,800.00	\$750.00	\$405.00
Lender Credits					

**Calculating Cash to Close**

Use this table to see what has changed from your Loan Estimate.

	Loan Estimate	Final	Did this change?
Total Closing Costs (J)	\$8,054.00	\$9,712.10	<b>YES</b> • See <b>Total Loan Costs (D)</b> and <b>Total Other Costs (I)</b>
Closing Costs Paid Before Closing	\$0	– \$29.80	<b>YES</b> • You paid these Closing Costs <b>before closing</b>
Closing Costs Financed (Paid from your Loan Amount)	\$0	\$0	<b>NO</b>
Down Payment/Funds from Borrower	\$18,000.00	\$18,000.00	<b>NO</b>
Deposit	– \$10,000.00	– \$10,000.00	<b>NO</b>
Funds for Borrower	\$0	\$0	<b>NO</b>
Seller Credits	\$0	– \$2,500.00	<b>YES</b> • See Seller Credits in <b>Section L</b>
Adjustments and Other Credits	\$0	– \$1,035.04	<b>YES</b> • See details in <b>Sections K and L</b>
<b>Cash to Close</b>	\$16,054.00	\$14,147.26	

**Summaries of Transactions**

Use this table to see a summary of your transaction.

**BORROWER'S TRANSACTION**

<b>K. Due from Borrower at Closing</b>	<b>\$189,762.30</b>
01 Sale Price of Property	\$180,000.00
02 Sale Price of Any Personal Property Included in Sale	
03 Closing Costs Paid at Closing (J)	\$9,682.30
04	
<b>Adjustments</b>	
05	
06	
07	
<b>Adjustments for Items Paid by Seller in Advance</b>	
08 City/Town Taxes to	
09 County Taxes to	
10 Assessments to	
11 HOA Dues 4/15/13 to 4/30/13	\$80.00
12	
13	
14	
15	
<b>L. Paid Already by or on Behalf of Borrower at Closing</b>	<b>\$175,615.04</b>
01 Deposit	\$10,000.00
02 Loan Amount	\$162,000.00
03 Existing Loan(s) Assumed or Taken Subject to	
04	
05 Seller Credit	\$2,500.00
<b>Other Credits</b>	
06 Rebate from Epsilon Title Co.	\$750.00
07	
<b>Adjustments</b>	
08	
09	
10	
11	
<b>Adjustments for Items Unpaid by Seller</b>	
12 City/Town Taxes 1/1/13 to 4/14/13	\$365.04
13 County Taxes to	
14 Assessments to	
15	
16	
17	
<b>CALCULATION</b>	
Total Due from Borrower at Closing (K)	\$189,762.30
Total Paid Already by or on Behalf of Borrower at Closing (L)	– \$175,615.04
<b>Cash to Close</b> <input checked="" type="checkbox"/> <b>From</b> <input type="checkbox"/> <b>To Borrower</b>	<b>\$14,147.26</b>

**SELLER'S TRANSACTION**

<b>M. Due to Seller at Closing</b>	<b>\$180,080.00</b>
01 Sale Price of Property	\$180,000.00
02 Sale Price of Any Personal Property Included in Sale	
03	
04	
05	
06	
07	
08	
<b>Adjustments for Items Paid by Seller in Advance</b>	
09 City/Town Taxes to	
10 County Taxes to	
11 Assessments to	
12 HOA Dues 4/15/13 to 4/30/13	\$80.00
13	
14	
15	
16	
<b>N. Due from Seller at Closing</b>	<b>\$115,665.04</b>
01 Excess Deposit	
02 Closing Costs Paid at Closing (J)	\$12,800.00
03 Existing Loan(s) Assumed or Taken Subject to	
04 Payoff of First Mortgage Loan	\$100,000.00
05 Payoff of Second Mortgage Loan	
06	
07	
08 Seller Credit	\$2,500.00
09	
10	
11	
12	
13	
<b>Adjustments for Items Unpaid by Seller</b>	
14 City/Town Taxes 1/1/13 to 4/14/13	\$365.04
15 County Taxes to	
16 Assessments to	
17	
18	
19	
<b>CALCULATION</b>	
Total Due to Seller at Closing (M)	\$180,080.00
Total Due from Seller at Closing (N)	– \$115,665.04
<b>Cash</b> <input type="checkbox"/> <b>From</b> <input checked="" type="checkbox"/> <b>To Seller</b>	<b>\$64,414.96</b>

## Additional Information About This Loan

### Loan Disclosures

#### Assumption

If you sell or transfer this property to another person, your lender

- will allow, under certain conditions, this person to assume this loan on the original terms.
- will not allow assumption of this loan on the original terms.

#### Demand Feature

Your loan

- has a demand feature, which permits your lender to require early repayment of the loan. You should review your note for details.
- does not have a demand feature.

#### Late Payment

If your payment is more than 15 days late, your lender will charge a late fee of 5% of the monthly principal and interest payment.

#### Negative Amortization (Increase in Loan Amount)

Under your loan terms, you

- are scheduled to make monthly payments that do not pay all of the interest due that month. As a result, your loan amount will increase (negatively amortize), and your loan amount will likely become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.
- may have monthly payments that do not pay all of the interest due that month. If you do, your loan amount will increase (negatively amortize), and, as a result, your loan amount may become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.
- do not have a negative amortization feature.

#### Partial Payments

Your lender

- may accept payments that are less than the full amount due (partial payments) and apply them to your loan.
- may hold them in a separate account until you pay the rest of the payment, and then apply the full payment to your loan.
- does not accept any partial payments.

If this loan is sold, your new lender may have a different policy.

#### Security Interest

You are granting a security interest in

456 Somewhere Ave., Anytown, ST 12345

You may lose this property if you do not make your payments or satisfy other obligations for this loan.

#### Escrow Account

**For now**, your loan

- will have an escrow account (also called an "impound" or "trust" account) to pay the property costs listed below. Without an escrow account, you would pay them directly, possibly in one or two large payments a year. Your lender may be liable for penalties and interest for failing to make a payment.

Escrow		
Escrowed Property Costs over Year 1	\$2,473.56	Estimated total amount over year 1 for your escrowed property costs: <i>Homeowner's Insurance</i> <i>Property Taxes</i>
Non-Escrowed Property Costs over Year 1	\$1,800.00	Estimated total amount over year 1 for your non-escrowed property costs: <i>Homeowner's Association Dues</i>  You may have other property costs.
Initial Escrow Payment	\$412.25	A cushion for the escrow account you pay at closing. See Section G on page 2.
Monthly Escrow Payment	\$206.13	The amount included in your total monthly payment.

- will not have an escrow account because  you declined it  your lender does not offer one. You must directly pay your property costs, such as taxes and homeowner's insurance. Contact your lender to ask if your loan can have an escrow account.

No Escrow		
Estimated Property Costs over Year 1		Estimated total amount over year 1. You must pay these costs directly, possibly in one or two large payments a year.
Escrow Waiver Fee		

#### In the future,

Your property costs may change and, as a result, your escrow payment may change. You may be able to cancel your escrow account, but if you do, you must pay your property costs directly. If you fail to pay your property taxes, your state or local government may (1) impose fines and penalties or (2) place a tax lien on this property. If you fail to pay any of your property costs, your lender may (1) add the amounts to your loan balance, (2) add an escrow account to your loan, or (3) require you to pay for property insurance that the lender buys on your behalf, which likely would cost more and provide fewer benefits than what you could buy on your own.

### Loan Calculations

<b>Total of Payments.</b> Total you will have paid after you make all payments of principal, interest, mortgage insurance, and loan costs, as scheduled.	\$285,803.36
<b>Finance Charge.</b> The dollar amount the loan will cost you.	\$118,830.27
<b>Amount Financed.</b> The loan amount available after paying your upfront finance charge.	\$162,000.00
<b>Annual Percentage Rate (APR).</b> Your costs over the loan term expressed as a rate. This is not your interest rate.	4.174%
<b>Total Interest Percentage (TIP).</b> The total amount of interest that you will pay over the loan term as a percentage of your loan amount.	69.46%



**Questions?** If you have questions about the loan terms or costs on this form, use the contact information below. To get more information or make a complaint, contact the Consumer Financial Protection Bureau at [www.consumerfinance.gov/mortgage-closing](http://www.consumerfinance.gov/mortgage-closing)

### Other Disclosures

#### Appraisal

If the property was appraised for your loan, your lender is required to give you a copy at no additional cost at least 3 days before closing. If you have not yet received it, please contact your lender at the information listed below.

#### Contract Details

See your note and security instrument for information about

- what happens if you fail to make your payments,
- what is a default on the loan,
- situations in which your lender can require early repayment of the loan, and
- the rules for making payments before they are due.

#### Liability after Foreclosure

If your lender forecloses on this property and the foreclosure does not cover the amount of unpaid balance on this loan,

- state law may protect you from liability for the unpaid balance. If you refinance or take on any additional debt on this property, you may lose this protection and have to pay any debt remaining even after foreclosure. You may want to consult a lawyer for more information.
- state law does not protect you from liability for the unpaid balance.

#### Refinance

Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.

#### Tax Deductions

If you borrow more than this property is worth, the interest on the loan amount above this property's fair market value is not deductible from your federal income taxes. You should consult a tax advisor for more information.

### Contact Information

	Lender	Mortgage Broker	Real Estate Broker (B)	Real Estate Broker (S)	Settlement Agent
<b>Name</b>	Ficus Bank		Omega Real Estate Broker Inc.	Alpha Real Estate Broker Co.	Epsilon Title Co.
<b>Address</b>	4321 Random Blvd. Somecity, ST 12340		789 Local Lane Sometown, ST 12345	987 Suburb Ct. Someplace, ST 12340	123 Commerce Pl. Somecity, ST 12344
<b>NMLS ID</b>					
<b>ST License ID</b>			Z765416	Z61456	Z61616
<b>Contact</b>	Joe Smith		Samuel Green	Joseph Cain	Sarah Arnold
<b>Contact NMLS ID</b>	12345				
<b>Contact ST License ID</b>			P16415	P51461	PT1234
<b>Email</b>	joesmith@ ficusbank.com		sam@omegare.biz	joe@alphare.biz	sarah@ epsilontitle.com
<b>Phone</b>	123-456-7890		123-555-1717	321-555-7171	987-555-4321

### Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

Applicant Signature

Date

Co-Applicant Signature

Date

CLOSING DISCLOSURE

PAGE 5 OF 5 • LOAN ID # 123456789

In addition to regulations pertaining to the Closing Disclosure regulations it also must be stated that to avoid violating RESPA, parties who are providing services to the buyer or seller in a transaction must disclose in writing any business relationship they have with other parties involved in the transaction, such as mortgage brokers, title companies, etc. For example, if a brokerage firm owns more than 1% of a title company, when salespeople at the firm recommend that title company, they must provide a written **Affiliated Business Arrangement** form so the consumer is aware that the brokerage firm benefits monetarily when that title company is chosen to provide insurance and closing services, and that they can choose to hire a different title company if they so desire.

## *Title Insurance*

Title insurance, like any insurance policy, protects the insured party against potential loss and as such is an integral part of the review process during the executory state of the contract. In this scenario, the grantee could be harmed by certain defects in the title, such as a forgery or error in the public record, other than those items listed in the policy as exceptions (items already known about). Title insurance is purchased once; there's no renewal of the policy. There are two types of policies: owner's and mortgagees' (lender's). An **owner's title insurance policy** is often purchased by the seller and benefits the buyer. The **mortgagee's policy** is purchased by the buyer and benefits the buyer's lender, since the lender usually has a large financial stake in the property.

While most insurance policies protect insured parties from events that might happen in the future, title insurance protects against actions that may have happened in the past. **Standard coverage** often covers those title issues that are recorded and therefore known; recorded documents give the public constructive notice. This policy will not cover situations arising from survey questions, defects of which the policyholder has knowledge, or unrecorded documents. An **extended coverage** policy will usually cover additional risks that may be discovered only by inspection of the property, including unrecorded rights of people in possession, or by examination of an accurate survey.

Before offering a title insurance policy, the title company will want to do some research to determine the level of risk involved. Liens such as unpaid judgments or federal tax liens can result in the property owner losing his property. For these reasons, it's imperative that a **title search** be performed to identify any unpaid liens or taxes so they can be paid by the seller at closing. A title search is an inspection of public records to determine if any defects exist in the chain of title (history of ownership). The inspection begins with the present owner and is traced backward for a short period of time. When the title company is satisfied with the outcome of the search, they provided the grantee with a written **title commitment** or a promise to issue a title insurance policy *at or after closing* under certain conditions and once the seller fixes certain issues.

A sample Title Commitment follows on the next pages.

**ALTA Commitment Form**

COMMITMENT FOR TITLE INSURANCE

Issued by

***First Integrity Title Company***

First Integrity Title Insurance Company, a Nebraska corporation ("Company"), for a valuable consideration, commits to issue its policy or policies of title insurance, as identified in Schedule A, in favor of the Proposed Insured named in Schedule A, as owner or mortgagee of the estate or interest in the land described or referred to in Schedule A, upon payment of the premiums and charges and compliance with the Requirements; all subject to the provisions of Schedules A and B and to the Conditions of this Commitment.

This Commitment shall be effective only when the identity of the Proposed Insured and the amount of the policy or policies committed for have been inserted in Schedule A by the Company.

All liability and obligation under this Commitment shall cease and terminate 90 days after the Effective Date or when the policy or policies committed for shall issue, whichever first occurs, provided that the failure to issue the policy or policies is not the fault of the Company.

The Company will provide a sample of the policy form upon request.

IN WITNESS WHEREOF, First Integrity Title Insurance Company has caused its corporate name and seal to be affixed by its duly authorized officers on the date shown in Schedule A.

First Integrity Title Insurance Company

**CONDITIONS**

1. The term mortgage, when used herein, shall include deed of trust, trust deed, or other security instrument.
2. If the proposed Insured has or acquired actual knowledge of any defect, lien, encumbrance, adverse claim or other matter affecting the estate or interest or mortgage thereon covered by this Commitment other than those shown in Schedule B hereof, and shall fail to disclose such knowledge to the Company in writing, the Company shall be relieved from liability for any loss or damage resulting from any act of reliance hereon to the extent the Company is prejudiced by failure to so disclose such knowledge. If the proposed Insured shall disclose such knowledge to the Company, or if the Company otherwise acquires actual knowledge of any such defect, lien, encumbrance, adverse claim or other matter, the Company at its option may amend Schedule B of this Commitment accordingly, but such amendment shall not relieve the Company from liability previously incurred pursuant to paragraph 3 of these Conditions and Stipulations.
3. Liability of the Company under this Commitment shall be only to the named proposed Insured and such parties included under the definition of Insured in the form of policy or policies committed for and only for actual loss incurred in reliance hereon in undertaking in good faith (a) to comply with the requirements hereof, or (b) to eliminate exceptions shown in Schedule B, or (c) to acquire or create the estate or interest or mortgage thereon covered by this Commitment. In no event shall such liability exceed the amount stated in Schedule A for the policy or policies committed for and such liability is subject to the insuring provisions and Conditions and Stipulations and the Exclusions from Coverage of the form of policy or policies committed for in favor of the proposed Insured which are hereby incorporated by reference and are made a part of this Commitment except as expressly modified herein.
4. This Commitment is a contract to issue one or more title insurance policies and is not an abstract of title or a report of the condition of title. Any action or actions or rights of action that the proposed Insured may have or may bring against the Company arising out of the status of the title to the estate or interest or the status of the mortgage thereon covered by this Commitment must be based on and are subject to the provisions of this Commitment.
5. The policy to be issued contains an arbitration clause. All arbitrable matters when the Amount of Insurance is \$2,000,000 or less shall be arbitrated at the option of either the Company or the Insured as the exclusive remedy of the parties. You may review a copy of the arbitration rules at <http://www.alta.org/>.

## COMMITMENT FOR TITLE INSURANCE FORM SCHEDULE A

1. Effective Date: June 25, 2024 at 7:30 AM
2. Policy or Policies to be issued:
 

	Amount
a. ALTA Owner Policy xxxxxx (xx-xx-xx)	\$0.00
Proposed Insured: Top Shelf Properties, LLC	
b. ALTA Loan Policy 1056.06 (06-17-06)	\$0.00
Proposed Insured:	
3. The estate or interest in the Land described or referred to in this Commitment is:  
Fee Simple
4. Title to the estate or interest in the land is at the Effective Date vested in:  
Second Bank National Trust Company, as Trustee, by virtue of a deed dated September 5, 2017,  
recorded in Book 17556, Page 840.

NOTE: As used herein "recorded" shall mean "recorded in the York County Registry of Deeds."

5. The Land referred to in this Commitment is described as follows:

Real property in the City of Biddeford, County of York, State of Maine, described as follows:

Certain real estate commonly known as Condominium Unit No. A-1 located in Building A in the Park Eleven Condominium situated on Route 111 (the Alfred Road, so-called), Biddeford, Maine.

The Declaration and By-Laws of said Condominium are dated November 26, 1986 and recorded in the York County Registry of Deeds in Book 4098, Page 281, and the plans of said Condominium, drawn by Dew & Coulombe, Inc. are duly recorded in said Registry, in Condominium File 238, Page 1-9. An Amendment to said Declaration, dated September 1, 1987 is recorded in said Registry in Book 4440, Page 84 and a second amendment dated March 16, 1988 is recorded in said Registry in Book 4642, Page 295, in each case with revised plans being also recorded there.

Said unit is conveyed together with the Allocated Interest of said unit as set forth in said Declaration. Said Unit and Allocated Interest is conveyed subject to all the terms and conditions of said Declaration and By-Laws.

The within conveyance is subject to any liens, encumbrances, rights, declaration and mortgage of record.

Meaning to convey and conveying the property conveyed to the Grantors by Deed recorded

**COMMITMENT FOR TITLE INSURANCE FORM**  
**SCHEDULE B**  
**SECTION ONE**  
**REQUIREMENTS**

The following requirements must be met:

1. Proper instrument(s) creating the estate or interest to be insured must be approved, executed, and duly filed for record, to wit:
  - a. Deed from current owner of record to the Proposed Owner to be insured.

THE MAINE REVENUE SERVICES REAL ESTATE TRANSFER TAX DECLARATION FORM, TITLE 36, M.R.S.A. SECTIONS 4641-4641N, MUST BE COMPLETED AND SUBMITTED WITH THE DEED FOR RECORDING.

Non-Maine residents who sell real property located in Maine are subject to a withholding from the total sale price of the property, to be used as an estimated tax payment towards any Maine tax liability on the gain realized from the sale. The buyer of the property will withhold and remit the Real Estate Withholding money to Maine Revenue Services using form REW-1. The amount to be withheld is equal to 2.5% of the sale price. Some individuals may be eligible for an exemption or reduction of the required REW payment. To apply for an exemption or reduction, use Form REW-5. This form must be submitted at least 5 business days prior to the closing. Forms not received timely may be denied an exemption or reduction. More information and instructions can be found on their forms page, from the link below:

<http://www.maine.gov/revenue/incomeestate/rew/>

- b. Mortgage from the Proposed Owner to the Proposed Lender to be insured.
2. Payment to or for the account of the grantors or mortgagors of the full consideration for the estate or interest to be insured.
3. Provide to First American within 2 weeks of closing/funding written proof of payment of all real estate taxes, water and sewer use charges, assessments, and any other matters with interest thereon which would be disclosed by a current search.
4. Release, termination, discharge, or subordination of the following matters which appear of public record:
  - a. TBD, see Schedule B-II
5. Receipt of a standard Mechanic's Lien/Parties in Possession Affidavit and Indemnity Form certifying that any improvements and/or repairs or alterations thereto are completed, that contractors, sub-contractors, laborers and materialmen are all paid and have released of record all liens or notices of

intent to perfect a lien for labor or material, plus identification of parties in possession, including rent roll, if appropriate.

6. Receipt of Full on ground ALTA/ACSM survey and surveyor's report, including certification from Surveyor that the property described in Exhibit A hereof is the same as that on the plan, in order to delete Item 2 of Schedule B, Section 2 herein. Survey to locate and define all recorded exceptions noted in Schedule B, section 2, and reflects matters which are satisfactory in the Company's sole discretion.
7. Authority documents for all parties executing documents including the following:

Corporation:

- a. Certificate of Incorporation from Secretary of State of state of formation.
- b. Certificate of Legal Existence and Good Standing from Secretary of State of state of formation.
- c. Copies of articles of organization and corporate by-laws.
- d. Clerk's certificate and Certificate of incumbency to be provided with copy of Corporate Resolution authorizing officers' action.

Limited Liability Company:

- a. Documents to be signed by member, manager, officer or other authorized agent of the LLC.
- b. Certificate of Legal existence/Good standing from the Secretary of State of state of formation, disclosing names of members) or manager(s) authorized to act on behalf of company, and naming person or entity authorized to act with respect to real estate.
- c. Copy of LLC's articles of organization and operating agreement.
- d. Written approval by authorized member(s) or manager(s).
- e. If any LLC member or manager is a corporation, see requirements for corporations (above).

Limited Partnership:

- a. Documents to be signed by general partner(s).
- b. Copy of Limited Partnership Agreement and all amendments identifying the general partners.
- c. Certificate of Good Standing from Secretary of State in state of formation.
- d. If general partner is a corporation, see requirements for corporations (above).

General Partnership:

- a. Copy of general partnership agreement and all amendments.
- b. Certificate by a general partner, certifying Partnership to be in full force and effect and identifying the partners of said Partnership.
- c. If any partner is a corporation, see requirements for corporation (above).

Trust:

- a. Copy of the Trust instrument to be provided to the Company for review.
- b. Trustee's Certificate to be recorded indicating that the trustee or trustees are actually trustees under the instrument of trust, that the trust is in existence and has not been amended or revoked, at and that the trustee or trustees have the authority to convey.

8. Payment of the premiums, fees and charges for the policy.
9. Maine Recording Fee and Transfer Tax Information:

- a. Maine Transfer Tax information: ME Real Estate Transfer Tax is assessed at \$2.20 for each \$500 or fractional part of \$500 of the value of the property being transferred. The tax is imposed 1/2 on the grantor, 1/2 on the grantee.

More information can be found online at:

<http://www.state.me.us/revenue/propertytax/transfertax/transfertax.htm>

or by contacting ME Revenue Services at 207-287-2012.

TITLE 36, M.R.S.A. SECTION 5250-A PROVIDES THAT A BUYER OF REAL PROPERTY LOCATED IN MAINE MUST WITHHOLD TAX IN THE AMOUNT OF 2.5% OF CONSIDERATION IF THE SELLER IS NOT, AS OF THE DATE OF THE TRANSFER, A RESIDENT OF THE STATE OF MAINE. FORM REW-3 IS TO BE ATTACHED TO THE MAIN REVENUE SERVICES REAL ESTATE TRANSFER TAX DECLARATION FORM AT THE TIME OF RECORDING.

- b. There are no Mortgage Taxes in Maine.
- c. There is no Leasehold Transfer Tax in Maine.
- d. Recording fees in Maine are as follows:
- i. \$22.00 for the first page, \$2.00 for each additional page.
  - ii. Blanket Assignments are charged at the above-per page rate, plus \$8.00 per additional assignment.
  - iii. Blanket Discharges are charged at the above-per page rate, plus \$8.00 per additional discharge.
10. The Company reserves the right to raise any such additional exceptions and/or requirements as it deems necessary upon receipt of the details of the transactions and its review of the closing documents.

In the absence of title insurance, a seller may want to order a **title abstract**, which is a written, chronological summary of the property's title and other public records affecting rights and interests in the property. The abstract is usually reviewed by the buyer's attorney who includes an opinion about the state of the title, however that opinion is not a guarantee.

Some states or counties utilize the **Torrens System**, where title only passes when the conveyance has been registered on the title certificate itself. In this system, encumbrances have no legal effect until they are recorded on the title certificate.

There's a difference between marketable title (a.k.a. merchantable title) and **insurable title**. Insurable title may have, or does have, a known defect or defects in the chain of title, however a title insurance company has agreed in advance to provide insurance against those defects. If a property does not have a current, valid title insurance policy and there is a defect in the chain of title, the defect must be cured or repaired before a seller can convey marketable title. If there is a current policy, rather than curing or fixing the defect, the title insurance company may elect to insure against any problem the defect may cause in the future. The insurance company agrees to fix the defect only when, and if, it becomes an immediate problem.

Here are some sample title issues:

- Errors in the public records – Clerical or filing errors could affect a property's deed or survey.
- Unknown liens – Sometimes liens from previous owners have been placed on the property (i.e., mechanic's liens).
- Illegal deeds – While the chain of title may appear sound, it is possible that a prior deed was made by a minor, a person of unsound mind, or someone who was not legally allowed to create the deed. These cases may affect the enforceability of prior deeds.
- Missing heirs – When a person dies, the ownership of their home may fall to their heirs, or those named in their will. Sometimes those heirs are missing or unknown at the time of death. Family members who may contest a will could also affect rights of current property owners.
- Forgeries – Forged or fabricated documents that affect property ownership could be filed with the county clerk and recorder. Once these forgeries come to light, they can affect ownership.

- Undiscovered encumbrances – Parties may hold a property claim through a former mortgage or lien. Also, other non-financial claims may come to light such as deed restrictions/conditions or covenants.
- Boundary/survey disputes – Previous surveys may show different boundary measurements leading to boundary disputes.
- Undiscovered will – When a property owner dies with no apparent will or heir, the state may sell the deceased’s assets, including real property. Years later, the deceased owner’s will may be found and could seriously jeopardize a current property owner.
- False impersonation of previous owners – Common and similar names can make it possible to falsely “impersonate” a property owner.

The good news is that there are often ways to cure title problems. A suit to quiet title, also known as a quiet title suit, is a court action to cure a cloud on title or gap in the chain of title.

The actual title insurance policy will go into effect at the moment the Grantee receives title from the Grantor at the time of closing.

---

## Trust / Escrow Accounts

---

Most states require a brokerage firm to maintain a **trust or escrow account** for the purpose of holding all funds entrusted to the brokerage that belong to clients in connection with a real estate transaction, such as earnest money. Brokers and salespeople are required to promptly deposit any funds received from a client or customer into the trust account or give those funds to the principal broker who must do the same. Most states require that a real estate broker working as a fiduciary deposit any trust funds received within 24 to 72 hours after acceptance of an offer.

The purpose of the trust account is to keep the broker’s money separated from the client’s money. Neither the broker nor his or her salespeople may use a client’s money in their trust account for their own use. Using the

client's money would be an example of **conversion**. Brokers may not mix their own money with their client's money, which is called **commingling**. Either conversion or commingling of funds in the broker's trust would result in disciplinary actions by the state licensing board. A broker is required to keep detailed records regarding deposits and disbursements of funds placed in their care.

Escrow Accounts can be utilized by both brokers and closing/escrow services for use in the collection and disbursement of monies in a real estate transaction.

---

## Dollars and Cents

---

The closing entity (title company, attorney, escrow agent, etc.) usually prepares a **settlement statement** that itemizes all the moneys each party pays or receives. The seller's closing or settlement statement contains the seller's income and expenses, ending with an amount either due to or from them. The buyer's closing or settlement statement does the same for the buyer. The buyer's debits are totaled and compared with the total number of buyer's credits. The excess of debits over credits is the amount the buyer must bring to the closing in the form of **good funds**: a cashier's check, certified check, or wire transfer.

Money received by a party is a  
**CREDIT**



Money due from a party is a  
**DEBIT**



<b>SELLER</b>	
<b>Debits</b>	<b>Credits</b>
<ul style="list-style-type: none"> <li>Expenses (per agreement or custom)</li> <li>Seller's share of prorated items the buyer will pay. (Items paid in Arrears)</li> <li>Loan balance or other liens to be paid off.</li> </ul>	<ul style="list-style-type: none"> <li>Purchase price</li> <li>Buyer's share of prorated items prepaid by seller (Items paid in Advance)</li> </ul>

The largest credit the seller receives is the purchase price. Common seller debits or expenses are owner's title insurance, current loan payoff, notary fees that benefit the seller, and real estate commissions due to the brokerage firm(s). **Seller net proceeds** are determined by subtracting all of the sellers' debits from their credits.

**Excelsior Title Company, LLC**  
 4000 Excelsior Drive 212  
 Anyplace, CO 80900 PHONE:  
 555-555-5555

---

**SELLERS SETTLEMENT STATEMENT**

SETTLEMENT DATE: January 7, 20xx      CASE NO.: XXXXXXXX  
 PROPERTY ADDRESS: 4398 Contemporary Drive, Anyplace, CO 80900      DATE OF PRORATION: January 7, 20xx  
 SELLER: John and Mary Ann Doe      PURCHASER: Richard R. Richardson

LEGAL DESCRIPTION: Lot 6, Flaming Arrow Mesa Pl No 1, County of Anywhere, State of Colorado.

DESCRIPTION	DEBIT	CREDIT
Sale Price of Property		\$315,000.00
Title - Bundled RE Closing Fee to Excelsior Title Company, LLC (DT)	\$170.00	
eRecording & Processing Fee to eFile, LLC	\$5.00	
Power of Attorney to eFile, LLC	\$13.00	
Title - Owner's Title Insurance to Excelsior Title Company, LLC (DT)	\$677.00	
Title - OEC - PlnLang. Endorsement to Excelsior Title Company, LLC	\$65.00	
(DT) Estimated 20xx Property Taxes due to Anywhere County Treasurer	\$2,182.75	
Real Estate - Broker Admin to XYZ Realty	\$49.50	
Real Estate Commission - Listing to PDQ Realty	\$8,820.00	
Real Estate Commission - Selling to XYZ Realty	\$9,450.00	
Invoices # 1511 to Rodriguez Properties	\$400.00	
Payoff of First Mortgage Loan to Chase	\$215,778.79	
County Property Taxes 1/1/20xx thru 1/6/20xx	\$31.12	
<b>Sub-totals</b>	<b>\$238,087.66</b>	<b>\$315,000.00</b>
Due To Seller	\$76,912.34	
<b>TOTALS</b>	<b>\$315,000.00</b>	<b>\$315,000.00</b>

APPROVED AND ACCEPTED

Sales or use taxes on personal property not included. EXCELSIOR TITLE COMPANY, LLC assumes no responsibility for the adjustment of special taxes or assessments unless they are shown on the Treasurer's Certificate of Taxes Due. The condition of title to the property is to be determined by reference to the title evidence provided by Seller or by personal investigation. The above statement of settlement is approved as of the settlement date shown above and EXCELSIOR Title Company, LLC is hereby authorized to disburse funds as indicated herein.

Seller

\_\_\_\_\_  
Broker Agent

\_\_\_\_\_  
Closing Agent

<b>BUYER</b>	
<b>Debits</b>	<b>Credits</b>
<ul style="list-style-type: none"> <li>Purchase Price</li> <li>Expenses (by contract or agreement)</li> <li>Loan Costs</li> <li>Buyer's share of prorated items prepaid by seller (Items paid in advance)</li> </ul>	<ul style="list-style-type: none"> <li>Earnest Money</li> <li>Loan amount (borrowed or assumed)</li> <li>Seller's share of prorated items the buyer will pay (Items paid in arrears)</li> </ul>

The largest debit for the buyer is the purchase price. Most items on the buyer's settlement statement are also debits such as the appraisal, credit report, lender's title insurance, hazard/homeowner's insurance, notary fees that benefit the buyer and recording fees. The buyer gets a credit for any earnest money deposited when the purchase contract was signed and for a mortgage loan amount borrowed from a lender or assumed from the seller.

**Excelsior Title Company, LLC**  
 4000 Excalibur Drive  
 212 Anyplace, CO 80900  
 PHONE: 353-353-3535

---

**PURCHASERS SETTLEMENT STATEMENT**

CASE NO.: XXXXXXX

SETTLEMENT DATE: January 7, XXXXX      DATE OF PRORATION: January 7, XXXX

PROPERTY ADDRESS: 4398 Contemporary Drive, Anyplace, CO 80900      1

SELLER: John and Mary Ann Doe      PURCHASER: Richard R. Richardson

LEGAL DESCRIPTION: Lot 6, Fleming Arrow Mesa PH No 1, County of Anywhere, State of Colorado.

DESCRIPTION	DEBIT	CREDIT
County Property Taxes 1/1/20xx thru 1/6/20xx		\$31.12
Deposit		\$2,000.00
Loan Amount		
from JIT Mortgage, Inc.		\$315,000.00
Lender Credits		\$751.50
Sale Price of Property	\$315,000.00	
0.75% of Loan Amount (Points)	\$2,362.50	
Appraisal Fee to Summit Appraisals, Inc.	\$750.00	
Credit Report Fee to Scary Credit Services	\$25.00	
Title - Lender's Title Insurance to Excelsior Title Company, LLC (DT)	\$491.00	
Closing Protection Letter to Excelsior Land Title Insurance Company	\$25.00	
Title - Bundled Loan Closing Fee to Excelsior Title Company, LLC	\$350.00	
(DT) Title - Bundled RE Closing Fee to Excelsior Title Company, LLC (DT) eRecording & Processing Fee to eFile, LLC	\$170.00	
Recording Fee (Deed) to eFile, LLC	\$35.00	
Recording Fee (Mortgage) to eFile, LLC	\$13.00	
Transfer Tax to eFile, LLC	\$68.00	
Homeowner's Insurance Premium to Stupendous Insurance	\$31.50	
Prepaid Interest \$25.89 per day from 01/07/2020 to 02/01/2020	\$1,404.00	
Homeowner's Insurance \$117.00 per month for 3 mo.	\$647.25	
Property Taxes \$181.90 per month for 2 mo.	\$351.00	
Aggregate Adjustment	\$363.80	
	-\$415.90	
<b>Sub-totals</b>	<b>\$321,671.15</b>	<b>\$317,782.62</b>
Due From Purchaser		<b>\$3,888.53</b>
<b>TOTALS</b>	<b>\$321,671.15</b>	<b>\$321,671.15</b>

**APPROVED AND ACCEPTED**

Sales or use taxes on personal property not included Excelsior TITLE COMPANY, LLC assumes no responsibility for the adjustment of special taxes or assessments unless they are shown on the Treasurer's Certificate of Taxes Due. The condition of title to the property is to be determined by reference to the title evidence provided by Seller or by personal investigation. The above statement of settlement is approved as of the settlement date shown above and Escrow Holder is hereby authorized to disburse as Trustee funds as indicated.

Purchaser \_\_\_\_\_

Broker/Agent \_\_\_\_\_

Closing Agent \_\_\_\_\_

In some cases, expenses are to be shared or **prorated** between the seller and the buyer. Examples of these expenses include property taxes, utility bills, rents (which are shared income), mortgage interest or homeowners' association dues.

## Math- Prorating Expenses

In determining the proration or amount of a shared expense for which the buyer and seller are each responsible, there are a few rules to remember.

- 360 days in a year.
- 30 days per month.
- Seller owns day of closing.

Here are the steps:

1. Identify the total dollar amount to be prorated.
2. Determine the number of days in the period (year, quarter, month).
3. Determine if the bill was paid in advance (beginning of the period) or arrears (after the period).

ITEMS PAID IN ARREARS OR ADVANCE	
Arrears	Advance
<ul style="list-style-type: none"> <li>• Real Estate Taxes</li> <li>• Mortgage Interest</li> <li>• Utilities (sometimes)</li> </ul>	<ul style="list-style-type: none"> <li>• Insurance Premiums</li> <li>• Rents received by Seller</li> <li>• Utilities (sometimes)</li> </ul>

The seller should be reimbursed or credited for the amount the buyer is responsible for when bills are paid by the seller in advance. We say *Buyer Owes Seller* or debit the buyer, credit the seller.

The buyer should be reimbursed or credited for the amount the seller is responsible for when bills are paid in arrears by the buyer (the homeowner at the time the bill is presented). We say *Seller Owes Buyer* or debit the seller, credit the buyer.

4. Divide the total amount by the number of days in the term to get a daily rate.
5. Multiply the daily rate times the number of days of ownership.

***Question 1 – The property taxes for this year are \$1,682 and are due in arrears. The property closes on October 13<sup>th</sup>. What is the proration for the buyer and the seller?***

**Step 1** – Determine the total amount to be prorated - **\$1,682**

**Step 2** – Determine the total amount of time in the period – **360 days (taxes are usually paid on an annual basis)**

**Step 3** – Determine who receives the Debit and Credit. (The bill is due in arrears, therefore the Seller Owes the Buyer. **DEBIT SELLER / CREDIT BUYER**).

**Step 4** – Determine the per diem (daily) rate -  **$\$1,682 \div 360 = \$4.67$  per day**

**Step 5** – Determine the total number days the Seller owes for. The seller owes for all of the days he or she owned the house (January 1 – day of closing on October 13). Utilizing 30 days in every month, the number of days is determined by adding all days of seller's ownership, including the day of closing.

<b>January</b>	<b>30</b>
<b>February</b>	<b>30</b>
<b>March</b>	<b>30</b>
<b>April</b>	<b>30</b>
<b>May</b>	<b>30</b>
<b>June</b>	<b>30</b>
<b>July</b>	<b>30</b>
<b>August</b>	<b>30</b>
<b>September</b>	<b>30</b>
<b>October</b>	<b><u>13</u></b>
<b>Total</b>	<b>283</b>

**Step 6** – Determine amount seller owes - 283 (days) x \$4.67 (per diem) = **\$1,321.61**

**ANSWER: \$1,321.61 DEBIT SELLER / \$1,321.61 CREDIT BUYER**

**Question 2 – The seller paid the quarterly homeowner’s association fee of \$125 in advance. The property closes on April 24<sup>th</sup>. What is the proration for the buyer and the seller?**

**Step 1** – Determine the total amount to be prorated - **\$125**

**Step 2** – Determine the total amount of time in the period – **90 days (quarterly fee)**

**Step 3** – Determine who receives the Debit and Credit. (The bill was paid in advance, therefore the Buyer Owes the Seller. **DEBIT BUYER / CREDIT SELLER**).

**Step 4** – Determine the per diem (daily) rate -  **$\$125 \div 90 = \$1.39$  per day**

**Step 5** – Determine the total number days the Buyer owes for. The buyer owes for the days he or she will own the house covered by the bill, so from the day AFTER closing (April 25<sup>th</sup>) through the end of June. April 25<sup>th</sup> will be counted as a day of ownership for the Buyer, however the day of closing belongs to the seller.

<b>April</b>	<b>6</b>
<b>May</b>	<b>30</b>
<b>June</b>	<b><u>30</u></b>
<b>Total</b>	<b>66</b>

**Step 6** – Determine amount buyer owes - 66 (days) x \$1.39 (per diem) = **\$91.67**

**ANSWER: \$91.67 DEBIT BUYER / \$91.67 CREDIT SELLER**

After completing a few proration problems, certain rules (which will help you chose the correct answers on the state exam) become obvious:

- Bills paid in advance are always *Buyer Owes Seller* - debit the buyer, credit the seller.
- Bills paid in arrears are always *Seller Owes Buyer* - debit the seller, credit the buyer.
- *Only the buyer and the seller* are affected, not the broker, the lender, the title company, etc.
- The *same dollar amount* is always debited from one party and credited to the other.

## *Income Taxes*

The Tax Reform Act of 1986 require that a real estate transaction must be reported to the Internal Revenue Service. The party that is filing (usually the closing/escrow agent) files a **Form 1099-S** information return with the Internal Revenue Service. This form includes the names and addresses of the parties to the transaction and information about the sales proceeds. If the transaction involves a non-resident alien, the reporting person may also have tax reporting and withholding responsibilities under the **Foreign Investment and Real Property Tax Act** of 1980 (**FIRPTA**). A withholding of up to 15% of the amount realized in sale may be required as withholding from a non-resident home seller.

Sellers should consider income taxes due on any profit resulting from the sale and discuss a planned home sale with their CPA or a tax accountant. The Tax Relief Act of 1997 provided an exclusion for married couples of up to \$500,000 for **capital gains** when selling their principal residence, while individual tax filers are entitled to up to \$250,000 capital gains exclusion on the sale of their principal residence. The exclusions are allowed for one sale every two years and there is no limit on the number of times homeowners may use them.

There are specific conditions, such as either spouse owning the property for two of the last five years, both spouses using the property as their principal residence for two of the last five years, and both spouses must file a joint return for the taxable year of the sale. Additionally, capital gains tax is applied towards the adjusted or **realized gain or loss** on the home's sale. To determine the gain, the initial home purchase plus the costs of any improvements made is subtracted from the sales price, less selling expenses such as real estate commissions.

### CAPITAL GAIN – EXCLUSION SCENARIO

Married couple Sam and Belinda bought their home in 2012 for \$175,000. They paid \$10,000 to have a large concrete patio and pergola installed in 2013 and finished the basement in 2015 for \$25,000. They sold the property in 2022 for \$350,000, spending \$6,000 in real estate commissions. Did they owe capital gains taxes on their sale?

PURCHASE		SALE		REALIZED GAIN (LOSS)	
Purchase Price	\$175,000	Sales Price	\$350,000	Net Selling Price	\$344,000
Patio and Pergola	+\$10,000	Commissions	-\$6,000	Total Basis	- \$210,000
Basement Finish	+\$25,000				
Total Basis	\$210,000	Net Selling Price	\$344,000	Net Deferred Gain	\$134,000

**ANSWER: No. The couple can exclude all of the net deferred gain because it was less than \$500,000.**

Under Section 1031 of the IRS Code, real estate *investors* can defer taxation of capital gains by making a **1031 property exchange**. A property owner may exchange their non-owner-occupied property for another like-kind property and have a tax liability on the sale only if an additional capital or property is received. Like-kind refers to any real property to be held for income purposes or investment. Tax on the exchange is deferred – NOT eliminated. Use of a qualified intermediary (accommodator) to retain the money in the tax-deferred exchange is required.

### Other Taxes

There may also be one-time only charges (taxes) on some portion of a transaction involving real property. **Transfer fees, conveyance tax or revenue stamps** are basically taxes charged based on the sales price of the property. Usually, taxes are calculated as an amount per \$100 or \$1000 of the value of the property or the sales price.

#### TRANSFER FEE EXAMPLE

A transfer fee is \$.60 per \$100 of the sales price of the property. The property sells for \$100,000. What is the transfer fee?

$$\begin{aligned} \$100,000 \div 100 &= 1,000 \\ 1,000 \times \$0.60 &= \$600 \end{aligned}$$

**ANSWER: The transfer fee is \$600**

# Chapter 11 Key Point Review

---

1. Escrow or Closing
  - a. Responsibilities of escrow agent.
    - i. An escrow or closing agent is a neutral third party authorized to coordinate the closing activities of a real estate transaction.
    - ii. Responsibilities include:
      1. Holding financial documents in trust.
      2. Gather required legal documents.
      3. Ordering an examination on the property.
      4. Preparing specific closing instructions.
      5. Gathering documents from the buyer's lender.
      6. Ensuring that all terms of the offer to purchase have been completed.
      7. Recording any necessary documents, such as the deed.
  - b. Closing Statements / RESPA / TRID Disclosures
    - i. The TILA – RESPA Integrated Disclosure (TRID) rule became effective on October 3, 2015.
    - ii. The rule requires the use of new integrated disclosure forms for consumers at the time of application (Loan Estimate) and Settlement (Closing Disclosure).
    - iii. The Loan Estimate must be placed in the mail or delivered to the buyer not later than the third business day after receiving their application.
    - iv. The buyer must receive the Closing Disclosure at least three business days prior to closing.
      1. A new three-day Closing Disclosure may be required to be provided to the buyer if certain items change.
      2. Saturday is considered a business day for the Closing Disclosure.
  - c. Title Insurance
    - i. Protects the insured party against loss resulting from certain defects in the title, such as a forgery or defect in the public record, other than those items listed in the policy as exceptions (items already known about).
    - ii. Two types of policies: Owner's (covering the buyer) and Mortgagee's (covering the lender).
    - iii. Standard Coverage

1. Usually, will not cover situations arising from questions of survey, defects of which the policy-holder has knowledge or unrecorded documents.
- iv. Extended Coverage
  1. Usually, will cover additional risks that may be discovered only by inspection of the property; including unrecorded rights of people in possession, or by examination of an accurate survey.
- d. Title Searches, Title Abstracts, Chain of Title
  - i. Title search
    1. An inspection of public records to determine if any defects exist in the chain of title.
    2. The inspection begins with the present owner and is traced backward for a period of time.
  - ii. Title Abstract
    1. A written, chronological summary of the property's title records and other public records affecting rights and interests in the property.
      - a. Usually requires an attorney's review.
  - iii. The Torrens System
    1. Title only passes when the conveyance has been registered on the title certificate itself.
      - a. The Torrens title record is the title itself.
      - b. Encumbrances have no legal effect until they are recorded on the title certificate.
    2. Only used in a few states and counties.
  - iv. Chain of Title
    1. A record of ownership of a property that connects the present owner back to the earliest recorded owner.
    2. A break in the chain of ownership would create a gap or cloud in the chain of title.
- e. Marketable vs. Insurable Title
  - i. Marketable Title
    1. The chain of ownership (title) to a particular piece of property is clear and free from defects.
      - a. It can be marketed for sale without additional effort by the seller or potential buyer.

ii. Insurable Title

1. May have, or does have, a known defect or defects in the chain of title.
  - a. A title insurance company has agreed in advance to provide insurance against the defect affecting the property.
- iii. If a property does not have a current, valid title insurance policy and there is a defect in the chain of title, the defect must be cured or repaired before a seller can convey marketable title.
- iv. If there is a current policy, rather than curing or fixing the defect, the title insurance company may elect to insure against any problem the defect may cause in the future.
  1. The insurance company agrees to fix the defect only when, and if, it becomes an immediate problem.

f. Potential Title Problems and Resolutions

- i. Errors in the public records – clerical or filing errors could affect the deed or survey of a property.
- ii. Unknown liens – sometimes liens from previous owners may exist and have been placed on the property. (i.e. Mechanic’s liens).
- iii. Illegal deeds – while the chain of title may appear sound, it is possible that a prior deed was made by a minor, a person of unsound mind or someone who was not legally allowed to create the deed. These cases may affect the enforceability of prior deeds.
- iv. Missing heirs – when a person dies, the ownership of their home may fall to their heirs, or those named in their will. Sometimes those heirs are missing or unknown at the time of death. Family members who may contest a will for their own property rights could also affect the rights of current owners of a property.
- v. Forgeries – sometimes forged or fabricated documents that affect property ownership are filed within public records. Once these forgeries come to light it can affect ownership.
- vi. Undiscovered encumbrances – sometimes parties may hold a claim to a property through a former mortgage or lien. Also, other non-financial claims may come to light such as deed restrictions/conditions or covenants.
- vii. Boundary/survey disputes – previous surveys may exist on a property that show different boundary measurements leading to boundary disputes by neighbors.

- viii. Undiscovered will – when a property owner dies with no apparent will or heir, the state may sell their assets, including real property. Years later, the deceased owner’s will may come to light and could seriously jeopardize a current property owner.
- ix. False impersonation of previous owners – common and similar names can make it possible to falsely “impersonate” a property owner.

g. Cloud on Title, Suit to Quiet Title

- i. Cloud on Title – a defect in title, such as a recorded mortgage that had been paid in full but for which a satisfaction of mortgage was never recorded.
- ii. Suit to Quiet Title – a court action to cure a cloud or gap in the chain of title.

2. Trust/Escrow Accounts

- a. Utilized for holding of funds entrusted to the brokerage or closing entity for the benefit of the buyer or seller.
  - i. Held for closing.
  - ii. Held for earnest money.
  - iii. Sometimes held for repairs.
- b. Improperly using or mixing brokerage funds with clients’ funds is called commingling.

3. Dollars and Cents

- a. Closing entity prepares a settlement statement for both parties to the transaction.
  - i. Itemizes the money each party receives or pays.
    - 1. Monies owed are called Debits.
    - 2. Monies received are called Credits.
    - 3. Seller’s Statement contains the seller’s Debits and Credits.
      - a. Includes net Seller (net proceeds) will receive from the closing.
    - 4. Buyer’s statement contains the buyer’s Credits and Debits.
      - a. Includes the amounts the Buyer will need to bring to closing.
  - ii. Some items are prorated between buyer and seller.

1. Proration involves the sharing of responsibility between the seller and the buyer for items such as property taxes.
  - a. Other prorated items:
    - i. Utility bills
    - ii. Rents
    - iii. Mortgage interest
    - iv. Owners Association Dues
  - b. Prorations are calculated with the following:
    - i. 360-day year (30 days per month)
    - ii. Seller owns the day of closing
    - iii. Bills paid in advance – Debit Buyer / Credit Seller
    - iv. Bills paid in arrears – Debit Seller / Credit Buyer



## Chapter 11 Quiz (True/False)

---

It is suggested that you NOT write in this book and instead put your answers to the following True/False questions on a piece of blank paper so you can take this quiz as many times as you like. The answers can be found in Appendix A.

1. An abstract of title is a collection of legal documents that shows the chronological history of the real property.
2. Recording a title document proves it is legal.
3. Recording a document provides actual notice.
4. A title insurance policy is renewed every five years.
5. A title commitment is the same as a title insurance policy.
6. A title search must be done for a title commitment to be issued.
7. A title search would reveal an encroachment.
8. A title search would reveal a recorded easement.
9. A title search would reveal parties in possession.
10. Commingling is mixing of trust funds with the broker's operating funds.
11. Conversion is the act of using a client's earnest money funds to pay the brokerage firm's utility bill.
12. A trust account is also known as an escrow account.
13. A trust account is used to run the brokerage firm's business activities.
14. A trust account is used when holding monies belonging to others.
15. Being found guilty of commingling or conversion can lead to license discipline.
16. There are two types of title policies; owner's title policies and mortgagee's title policies.
17. There are two types of title coverages; standard coverage and owner's extended coverage.

18. The purpose of title insurance is to protect the insured party against loss resulting from certain title defects.
19. Standard coverage will protect against an undisclosed mechanic's lien.
20. The process of investigating public records to find any existing title defects on title is called chain of title.
21. The chronological history of all the property's title records affecting rights and interests in the property is known as chain of title.
22. Title passes in the Torrens System when the transfer has been registered on the Torrens Certificate.
23. A chain of title can identify any breaks or gaps in the chain of ownership to a property.
24. A marketable title is also known as a merchantable title and is free and clear from defects to a property.
25. A title commitment is a binding agreement to provide a title insurance policy at or after closing.
26. An encroachment would be found in a title search.
27. An encroachment would be found in a survey.
28. A title defect found before closing will be covered by the title insurance policy.
29. A title defect found after closing will be covered by the title insurance policy.
30. A defect on title must be cured before a seller can convey marketable title.
31. An abstract guarantees merchantable title.
32. Clerical or filing errors never happen with public records.
33. A cloud on title is a title defect found in public records.
34. A suit to quiet title, also known as a quiet title suit, is a court action to cure a cloud on title or gap in the chain of title.
35. Taxation on capital gains taxes can be deferred by using a 1031 exchange.

36. A closing/settlement statement will show commissions split between the broker and salesperson.
37. The loan payoff will show up on the buyer's closing statement.
38. The earnest money will show up on the buyer's settlement statement.
39. The notary fee for the mortgage or deed of trust will show up on the seller's closing statement.
40. A debit is a charge to the responsible party for an expense.
41. The seller's largest credit is the purchase price.
42. The earnest money is a buyer debit on the buyer's closing statement.
43. A VA loan is always a buyer debit.
44. Security deposits are prorated between the seller and the buyer.
45. Prorations are done using a 360-day year, 30-day month, and the seller owning on the day of closing.
46. When prorating real property taxes of \$1,800 (paid in arrears) with a closing date of August 15, the seller will be debited \$1,125.
47. To avoid capital gains tax, the seller must have lived in the property 3 out of the last 5 years.
48. The first \$250,000 (single) or \$500,000 (married) of proceeds may be excluded from capital gains tax for a principal residence.
49. The 1031 Exchange helps an investor eliminate paying taxes on their capital gains.
50. TRID requires the lender use the Loan Estimate and the Closing Disclosure.
51. The Loan Estimate must be delivered to the buyer no later than 3 business days after loan application.
52. Buyer must receive the Closing Disclosure at least 3 business days before closing.
53. Saturday is not considered a business day for the Closing Disclosure.

54. A seller received a rental payment of \$100 in advance. At closing, the seller has “earned” only \$32 of this rent. The closing statement shows a debit to the seller for \$32 and a credit to the buyer for \$100.
55. A sale is to be closed on April 15. Real estate taxes for the current year are \$1,860 and have not been paid. The proration will be \$1,317.49 credit to the buyer.
56. Greg sold his house for \$450,000. He agreed to pay his broker 7% of the sale price. Greg has a remaining balance of \$315,000 on his mortgage and also agreed to pay \$2,700 to repair his back deck. The owner’s title insurance policy costs \$1,000 and Greg’s portion of the real property taxes for the current year are \$890. The closing services fee of \$400 will be split equally between the buyer and the seller. Greg’s net proceeds are \$98,710.
57. In one state, the transfer tax is \$1.20 for each \$300 (or fraction of \$300) of the sales price of any parcel of real estate. If a seller’s property sold for \$250,000, the transfer tax will be \$1,000.

# Appendix A

## Answer Keys

### Answer Key for Chapter 1

1. A licensed non-profit corporation can be a real estate brokerage firm.	F
2. A licensed salesperson may only work for one employing broker at a time in any given state.	T
3. A salesperson is allowed to be paid by either the principal or their employing broker.	F
4. A property for sale may be advertised so long as the salesperson's name is in the advertisement.	F
5. If a broker employer hires a salesperson as an employee, the broker employer must withhold income and social security taxes from the salesperson's income.	T
6. If a broker hires a salesperson as an independent contractor, the broker must withhold income and social security taxes from the salesperson's income.	F
7. An employing broker is allowed to require an independent contractor salesperson to hold specific office hours or attend mandatory sales meetings.	F
8. An employing broker could be held liable for the actions of the salesperson.	T
9. An independent contractor salesperson must have a written independent contractor agreement with the employing broker.	T
10. A partnership and/or corporation is allowed to have a real estate license.	T
11. Many states require a specific amount of education before issuing a real estate license.	T
12. The public can't sell or buy, lease or find tenants on their own; they have to hire a licensed real estate professional.	F
13. Licensees' core role is to assist their clients in the accomplishment of their real estate goals while mitigating risk and operating within the law.	T
14. Once a real estate license is issued, there are no further educational requirements to keep that license active.	F
15. Most licensees do not choose to specialize and will handle commercial, residential and property management transactions.	F
16. Residential real estate covers single-family homes, duplexes, triplexes and/or fourplexes.	T
17. Licensees do not usually specialize in a geographical area as their license covers their entire state.	F
18. Real estate is a heavily regulated industry.	T
19. Licensees do not have to understand county zoning classifications.	F
20. Real estate licensee act as a buffer protecting their client's confidential information.	T
21. There are no trade associations for licensees.	F
22. All real estate brokerage owners must be licensed.	F
23. The employing broker or responsible broker must be licensed.	T
24. A licensee can only have an active license in one state.	F
25. A limited partnership can only be comprised of limited partners.	F

26. A limited partner is only liable up to the amount of their initial investment.	T
27. A real estate investment trust or REIT pools their money and buys real estate assets.	T
28. A business trust can't broker real estate.	T
29. All brokerage firms are affiliated with a national franchise.	F
30. Only the employing broker has a real estate license.	F
31. Locating a buyer for a seller is one of the services that a residential licensee offers on behalf of the brokerage firm.	T
32. It's perfectly acceptable for a salesperson to sign a contract on behalf of their client.	F
33. A broker would owe an independent contractor a written IC agreement and compensation based on production but not also business cards, leads, yard signs, etc.	T
34. A broker cannot provide an IC with employee benefits such as health insurance or pension plans.	T
35. A broker cannot provide an employee with employee benefits such as health insurance or pension plans.	F
36. Brokers have no responsibilities towards their licensees.	F
37. Licensees can locate a landlord for a tenant client.	T
38. The broker will provide whatever training was promised at the time of hiring, along with whatever office support may have been discussed.	T
39. The brokerage firm doesn't have to commit to a commission structure for licensees.	F
40. Licensees don't market listings, only the brokerage firm markets listings.	F
41. A salesperson should understand the current state of the housing industry in their area.	T
42. Licensees selling their own property through the brokerage firm do not need to disclose their brokerage firm's identity.	F
43. Purchasing or selling real estate for oneself is sometimes considered trading.	T
44. Helping a buyer or seller in a property transaction for a fee is an example of a brokerage service.	T
45. Providing an estimate of value for a potential seller is a brokerage service.	T
46. Providing an estimate of value for a bank that has not hired the brokerage firm would be considered a brokerage service.	F
47. One must have a real estate license to sell a business opportunity.	F
48. A real estate license is required to sell a business if any portion of the business asset includes a real property interest, be it ownership or a lease.	T
49. If the business interest has stock as part of the assets that are being sold, it might be necessary to hold a securities license as well as a real estate license.	T
50. Most independent contractors earn their compensation monthly.	F
51. An independent contractor's compensation is normally a combination of commissions and free office support.	T
52. There are three sides to every transaction – the listing side, the selling side and the brokerage side.	F
53. In most situations, licensees at the same brokerage firm represent the seller and the buyer in the same transaction.	F
54. Brokerage cooperation refers to two different brokerage firms working for different clients in a real estate transaction.	T
55. The listing brokerage firm (working with the seller) shares its negotiated commission with the selling brokerage firm (working with the buyer).	T
56. The listing brokerage firm (working with the seller) keeps its negotiated commission with the selling brokerage firm (working with the buyer). The selling brokerage firm can only be compensated by the buyer.	F

57. The selling brokerage firm works with the seller.	F
58. The listing brokerage firm negotiates a commission with the seller.	T
59. The MLS or Multiple Listing Service is a place for licensees to find brokerage firms looking to hire employees or independent contractors.	F
60. To calculate the commission earned by a licensee, first calculate the gross commission income generated through negotiations with the client.	T
61. All commissions are earned by the brokerage firm.	T
62. Commissions earned by the brokerage firm are paid to the salesperson based on the multiple listing service.	F
63. Commissions earned by the brokerage firm are paid to the salesperson based on the Independent Contractor agreement.	T
64. The first calculation when determining commissions owed is to take the sales price and multiply that by the commission rate negotiated with the client.	T
65. All licensees at 123 Realty are instructed to negotiate for a commission of 6% of the sales price, due at the successful culmination of the transaction. Of that 6%, the seller wants 2.85% to go to the licensee working with the buyer. If the house sells for \$550,000, the gross commission income for the selling brokerage firm is \$17,325.	F
66. In Quinn's IC agreement with 123 Realty, it states that she earns 80% of the commissions on her closed transactions. If her listing sells for \$425,000 and her company earns 3.5% at closing, her check from her brokerage firm will be \$11,900.	T

*Answer Key for Chapter 2*

1. The term "agent" refers to anyone with a real estate license.	F
2. An agent is a fiduciary in a relationship of trust and confidence with a principal who hired him/her to represent the principal in a transaction.	T
3. The common law of agency is only acknowledged in the United Kingdom.	F
4. Only roughly half of the states in the US utilize the common law of agency.	F
5. The principal is the person who hired an agent.	T
6. A customer hires an agent.	F
7. A principal is also considered unrepresented.	F
8. A limited agent is also known as a special agent and has a limited right to bind their principal.	F
9. A property manager is a general agent for their principal, the property owner.	T
10. A general agent is hired to do a series of acts for their principal and has a limited ability to bind their principal to a contract.	T
11. A salesperson is a general agent for a principal broker.	T
12. A Power of Attorney is the title given to a universal agent who has unlimited ability to bind a principal.	F
13. Real estate agents act as universal agents.	F
14. An attorney-in-fact replaces the principal and can sign contracts on behalf of the principal.	T
15. A single agent can represent two principals in the same transaction equally.	F
16. A listing agent is a single agent to the seller principal, while a selling agent is a single agent to the buyer principal.	T

17. A dual agent represents both a buyer and seller as an agent in the same transaction.	T
18. There are no conflicts of interest pertaining to fiduciary duties to both of the principals in a transaction in a dual agency relationship.	F
19. A dual agent must meet strict disclosure requirements and notify both principals.	T
20. When a seller and buyer have both hired the same brokerage firm to represent them, and the Broker does not utilize a Designated Brokerage relationship with their salespeople representing the seller and buyer, the brokerage firm/broker could be considered a dual agent.	T
21. A transaction-broker is also known as a non-agent.	T
22. A transaction-broker has an agency relationship with their principal and cannot be neutral.	F
23. A non-agent is not an advocate for either party.	T
24. The fiduciary duties of OLDCAR are owed to the principal by their agent.	T
25. The fiduciary duties of CARD are owed to the principal by the non-agent.	F
26. An agent only owes disclosure of material fact as a fiduciary duty to their client.	F
27. An agent must keep price, terms and motivation confidential on behalf of their principal.	T
28. A principal hires the licensee as their agent and the broker as their subagent.	F
29. A licensee is working with a seller. Another licensee in the same firm is working with a buyer. Their clients are under contract in the same transaction. Both principals hired the broker as an agent. The relationships now are dual agency with the broker, and the licensees are subagents.	T
30. The fiduciary duty of obedience is owed by a non-agent.	F
31. The fiduciary duty of full disclosure is owed by an agent.	T
32. Once a transaction has closed, agents can disclose a principal's confidential information.	F
33. The abbreviation OLDCAR pertains to the common laws of agency.	F
34. Both an agent and facilitator are responsible for the accounting of monies and personal property of their clients.	T
35. A buyer's agent owes the fiduciary duty of confidentiality to a For Sale by Owner.	F
36. A For Sale by Owner customer has a relationship with the buyer's agent.	F
37. A seller's agent is required to disclose his relationship with his client to an unrepresented buyer.	T
38. An implied agency may be created simply through the actions of the broker.	T
39. An agent would be violating their fiduciary duty of obedience if he discloses the leaking roof to a prospective buyer when the seller asked the agent not to disclose this information.	F
40. State laws make it optional for sellers to disclose material facts.	F
41. Only showing properties that give the agent the highest commission, not what fits the client's best needs, is a violation of the fiduciary duty of loyalty.	T
42. Disclosure of adverse material facts is required by an agent, a non-agent, and by a licensee working with a customer.	T
43. An express agency can be created verbally and still be enforceable by the Statute of Frauds.	F
44. Implied agency is illegal.	F
45. Death of the principal will not terminate the agency relationship and will require the heirs to complete the contract.	F
46. When advertising, puffing is considered to be a misrepresentation of the property.	F

47. Fraud is a misrepresentation of a fact with the intent to deceive and thereby potentially injuring another party.	T
48. Negligent misrepresentation is the unintentional act of deceiving and potentially injuring another party.	T
49. Adverse material facts are generally defined as a fact that, if known, would affect a buyer's opinions or actions.	T
50. Both agents and non-agents must provide exceptional skill and care to their principals.	F
51. The fiduciary duty of accounting requires the responsible broker to provide copies of the operational business banking accounts to all clients.	F
52. An agent is like a coach while a non-agent or transaction-broker is more like a referee.	T
53. Agents must be neutral.	F
54. It's impossible to terminate an agency relationship.	F
55. Agency relationships are only terminated when the contract's expiration date is reached.	F
56. An agent keeps her seller's garage door code on a sticky note on her desk where others can see it. She is violating the fiduciary duty of accounting.	T
57. While agents must treat all parties fairly, non-agents do not have to.	F
58. An agent must disclose environmental hazards to a customer.	T
59. An agent always recommends his wife as a lender when working with buyers but doesn't disclose that she is his spouse. This is a disclosure violation.	T
60. Full disclosure is not required when agents buy or sell real estate as a principal to the transaction.	F

*Answer Key for Chapter 3*

1. The Civil Rights Act of 1866 prohibits discrimination against color.	F
2. Title VIII of the Civil Rights Act of 1968 is also known as the Federal Fair Housing Act.	T
3. National origin is defined as a group of people identified as distinct from other groups because of physical or genetic traits.	F
4. The Federal Fair Housing Law prohibits discrimination against handicap, color, familial status, religion, age, national origin, and race.	F
5. As a protected class, sex refers to one's gender, including gender identity and sexual orientation.	T
6. Familial status protects those with children under the age of 18 and pregnant people.	T
7. Property owners are allowed to separate an apartment complex into an adult section and a family-friendly section for the safety of the children.	F
8. Senior housing is allowed to discriminate against familial status so long as at least 80% of the units are occupied by at least one individual who is 55 years old or older.	T
9. A person with AIDS is protected under the classification of handicap.	T
10. A landlord must allow a disabled tenant to make necessary modifications to the premises.	T
11. A landlord must pay for the modifications to the premises on behalf of the disabled tenant.	F
12. A disabled tenant may be required to remove any modifications done to the premises and pay for the reversal of the modifications.	T
13. A real estate professional is allowed to disclose to a seller or landlord that a prospective buyer or tenant is a member of a protected class.	F
14. Alcoholics and drug addicts seeking treatment are protected under the Federal Fair Housing Act.	T

15. Convicted drug dealers are protected under the handicap classification.	F
16. A landlord may evict a mentally ill tenant with a violent history.	T
17. A landlord or property manager may charge a pet deposit for a service animal.	F
18. A building built after March 1991 that does not comply with handicap accessible units and routes into and through the building is considered to be a failure to design.	T
19. Older building owners are required to make reasonable, achievable access accommodations for the disabled community.	T
20. The Americans with Disabilities Act give those with disabilities the right to full and equal access to public accommodations.	T
21. An aggrieved party may go to Housing and Urban Development to file a complaint within two years of alleged disparate treatment.	F
22. An aggrieved party may file a complaint with the federal court within two years of alleged disparate treatment.	T
23. Exemptions from Federal Fair Housing law are allowed so long as the property owner does not use a broker, use discriminatory advertising, currently lives in the home, and does not own more than three properties at one time.	T
24. There are no exemptions from Federal Fair Housing law.	F
25. Individuals who have been convicted of a crime are protected under Federal Fair Housing laws.	F
26. A landlord is allowed to discriminate against the protected classification of race so long as the landlord does not use a licensed property manager.	T
27. A religious organization may restrict to persons of the same religion if membership is not restricted on the basis of familial status, race, sex, handicap, color and national origin.	T
28. A private club may restrict lodging to its members only if lodgings are operated commercially.	F
29. Providing unequal services is also known as disparate treatment.	T
30. Requiring Hispanic buyers to provide a lender's pre-approval letter before showing property but not requiring the letter from Caucasian buyers is an example of steering.	F
31. A broker is required to accept all listings, even if the owner intends to violate the Federal Fair Housing laws to protect the value of the neighborhood.	F
32. A brokerage firm is required to post the Equal Housing poster in their place of business to avoid being accused of disparate treatment.	T
33. The law allows two or more brokerages to boycott another brokerage to reduce competition.	F
34. Multiple brokerage firms all agreed to charge the same commission rate to the public. This is price fixing and illegal and is addressed by the Sherman Antitrust Law.	T
35. Redlining is a discriminatory denial of loans or insurance due to selected areas, regardless of their qualification.	T
36. HUD allows a professional to describe who should live in the property in the advertisement.	F
37. Blockbusting is leading prospective buyers to or away from specific areas based on a protected classification.	F
38. Steering is also known as channeling.	T
39. Blockbusting is also known as panic selling or panic peddling.	T
40. Steering is inducing owners to sell their property because a minority has moved into the neighborhood.	F
41. State laws make it optional for sellers to disclose material facts.	F
42. Both sellers and licensees fill out the property disclosure before it is given to the buyer.	F
43. Sellers are required to disclose both obvious and latent defects that they are aware of to prospective buyers.	T
44. ECOA requires that all rejected credit applicants be informed in writing the reason(s) for credit denial within 30 days.	T

45. The CAN-SPAM Act addresses the regulation of unsolicited telemarketing phone calls.	F
46. Licensees do not have to abide by the Do-Not-Call list.	F
47. When the responsible broker at a company tells all agents they must negotiate commissions with clients between 6% and 8% they are price fixing.	F
48. A latent defect is any defect that is visible and would be uncovered by a normal inspection.	F
49. The Seller must disclose if they know of an ongoing or existing Environmental Impact Statement.	T
50. Lead hazards must be disclosed on properties built prior to January 1, 1979.	F
51. Lead hazards can be found in paint, soil and pipes.	T
52. It is safer to encapsulate asbestos than abatement.	T
53. Lead-based paint and asbestos removal is a standard coverage in an owner's title policy.	F
54. Radon is an odorless, colorless gas that is a known human carcinogen that should be mitigated once it is discovered through a radon test.	T
55. Carbon monoxide is a colorless, odorless gas which can cause sudden illness and even death.	T
56. If a combustion appliance is not operating properly, it may increase concentrations of radon.	F
57. Hidden structural damage is an example of a latent material defect.	T
58. A latent defect is considered a material fact.	T
59. A buyer should receive both the lead-based paint disclosure and the EPA pamphlet, Protect Your Family from Lead in Your Home, from a Seller.	T
60. Lead-based paint hazards must be disclosed with both residential and commercial properties if built prior to January 1, 1978.	F
61. Home warranty programs are used for previously owned homes.	T
62. A Hispanic student is protected by the Federal Fair Housing Act.	F

*Answer Key for Chapter 4*

1. Fixtures are automatically included with real property.	T
2. Land specifically refers to the surface and all natural things attached to it, but not what's below the surface or the airspace above it.	F
3. Subsurface includes the dirt, rocks, minerals, gas, oil, and water below the land.	T
4. Subsurface rights, or rights to the resources below the earth's surface, may be sold separately from the surface rights or they may be leased to others.	T
5. Air rights may not be sold or leased separately from the surface rights.	F
6. Riparian water rights describe rights for properties next to large bodies of water.	F
7. If the river is navigable, property owners own land to the water's edge.	T
8. If the river or stream is navigable, then property owners own the underlying land to the midpoint of the stream or river.	F
9. Littoral rights give properties on lakes the right to enjoy those waters up to the low-water mark.	F
10. Littoral rights refer to those given to properties that abut to seas or oceans.	T
11. After Hurricane Katrina, caused existing bodies of open water to be enlarged and fringing marsh areas to be reduced. This is an example of erosion.	F

12. Accretion is the addition of land as water deposits soil.	T
13. Building an improvement on a parcel of land rarely changes its value.	F
14. A plot of land's location is usually not a purchaser's primary concern.	F
15. A section contains 36 townships.	F
16. A section contains 640 acres.	T
17. A parcel of land described as W/2, SW/4, NW/4 of T8S, R14 W, of the 6 <sup>th</sup> Principal Meridian has 20 acres. (Solution: $640 \text{ acres} \div 2 \div 4 \div 4 = 20$ )	T
18. Section 8 is directly north of Section 16 in a township.	F
19. A prize-winning rose bush is an example of real property.	F
20. House keys are an example of a fixture.	T
21. A custom-built freestanding bookcase is an example of chattel.	T
22. Chattel is real property.	F
23. Trade fixtures are fixtures that are attached to real property.	F
24. Emblements are also known as crops and are personal property.	T
25. Annexation, Adaptation, and Agreement are the legal tests of a fixture.	T
26. Land is indestructible, immobile, and never depreciates.	T
27. Metes and Bounds legal descriptions use plat maps and are used in urban areas.	F
28. Monuments, points of beginning, and measurements are used with Metes and Bounds legal descriptions.	T
29. Rectangular survey is also known as government survey.	T
30. Ranges and meridians run north and south.	T
31. Tiers and base lines run north and south.	F
32. A township is six miles squared and has 36 sections.	T
33. One acre has 12,560 square feet.	F
34. The Doctrine of Prior Appropriation states that water rights are determined by priority of beneficial use.	T
35. Air rights, surface rights, and subsurface rights are part of real property.	T
36. A legal description may be based on information collected through an easement.	F
37. Sections 16 and 36 are set aside as school sections.	T
38. A datum is a point or line from which elevations are measured.	T
39. Garage space is not counted in square footage calculations.	T
40. When affixed, a ceiling fan converts from personal property to real property.	T
41. Through severance, a ceiling fan converts from personal property to real property.	F
42. Chattel transfers from one owner to another on a deed.	F
43. An owner decided to fence his 80' square lot. He will need 32 posts if starting at one corner and one post is placed every 10'. (Solution: $80' \times 4 \text{ sides} = 320 \text{ square feet. } 320 \div 10 = 32 \text{ posts}$ )	T

44. If a man sells six acres of prime, undeveloped property to a woman for \$2.25 per square foot, she paid \$612,360. (Solution: 1 acre = 43,560 square feet x 6 = 261,360 square feet x \$2.25 = \$588,060)	F
45. The annual rent per square foot for a 30' x 40' office space that rents for \$2,950 per month is \$29.50. (Solution: 30' x 40' = 1200 square feet. Annual rent is \$2,950 x 12 = \$35,400. Annual rent 35,400 ÷ 1200 square feet total = \$29.50 per square foot)	T
46. If a 10-acre lot sells for \$425,000, a similar 7-acre lot would sell for \$297,500. (Solution: \$425,000 ÷ 10 acres = \$42,500 per acre x 7 acres = \$297,500)	T

**Answer Key for Chapter 5**

1. An acknowledged document is a document that was signed and witnessed by a notary.	T
2. The parties involved with a conveyance deed are the grantor and the grantee.	T
3. A conveyance deed voluntarily transfers title from the grantor to the grantee.	T
4. A recorded deed gives constructive notice to the public.	T
5. There are five essential elements for a valid deed.	F
6. Recording is one of the essential elements of a valid deed.	F
7. A competent grantee is one of the essential elements of a valid deed.	F
8. A competent grantor must be 18, sane and sober.	T
9. Listing the legal description on the deed meets the essential element of lawful objective to make the deed valid.	F
10. A granting clause is one of the essential elements needed for a valid deed.	T
11. The signature of the grantee is one of the essential elements of a valid deed.	F
12. Conveyance happens when the final essential element of a valid deed, delivery and acceptance, is exercised.	T
13. The habendum clause identifies the type of freehold estate that is being granted.	T
14. A general warranty deed conveys seven covenants (promises) from the grantor to the grantee.	F
15. The covenant of seizin allows the grantor reversionary interest in case of foreclosure.	F
16. The covenant of quiet enjoyment guarantees the grantee to have quiet neighbors.	F
17. The covenant against encumbrances is a promise from the grantor will convey the property free from any liens or encumbrances except those stated in the deed.	T
18. The covenant of further assurance is a promise from the grantor to obtain and deliver any instrument required to make the title good against third parties.	T
19. The covenant of warranty forever provides the grantor's commitment to get and provide whatever is needed to defend the title against third-party claims made before the grantor owned the property.	T
20. A general warranty deed is best for the grantee.	T
21. A quitclaim deed is best for the grantee.	F
22. A quitclaim deed is known as a problem solver and can be used to clear a cloud on title.	T
23. Real property is transferred using a Bill of Sale.	F
24. Personal property is transferred using a Bill of Sale.	T
25. A deed must be acknowledged/notarized for it to be considered valid.	F
26. A deed must be recorded for it to be considered valid.	F
27. Recording the deed benefits the grantor.	F
28. Recording a title document proves it is legal.	F
29. A dower is the surviving rights of a widow in the real property of a deceased husband.	T
30. A curtesy is the widow's right in a deceased spouse's real property.	F

31. Joint tenancy allows for unequal interests in real estate.	F
32. A life estate is inheritable upon the death of a life tenant.	F
33. Tenants in common have the right of survivorship.	F
34. A life estate must have a Pur Autre Vie.	F
35. A life estate is a freehold estate.	T
36. A lien is a possessory interest in real estate.	F
37. In a general partnership, the partners share in the liability of the partnership and are entitled to their share of the profits.	T
38. In a limited partnership, the limited partner is only liable for the amount that was invested in the limited partnership.	T
39. A corporation is considered to be multiple persons when taking title to real property.	F
40. Timeshare owners have unlimited use of their property.	F
41. Timeshares are typically found in resort locations.	T
42. Real property taxes are a junior lien.	F
43. Special assessments are a superior involuntary lien.	T
44. A mortgage is a voluntary general lien.	F
45. Joint tenancy has the right of survivorship.	T
46. Tenants in common may have unequal ownership shares.	T
47. Condominium owners own common elements as tenants in common with the other owners.	T
48. With a cooperative, one would receive stocks in the corporation and a conveyance deed.	F
49. Upon the death of a life tenant, the life estate may revert to fee simple absolute to the reverter.	T
50. When a life estate passes to a third party, that interested party is considered the Remainderman.	T
51. In a cooperative, the real property is owned by the unit owners.	F
52. When a joint tenant dies, their interest passes to their heirs or devisees.	F
53. Community property is all assets purchased or acquired by a couple during their marriage owned equally by both of them.	T
54. Mechanic's liens are superior liens.	F
55. The priority for a mechanic's lien is established as of either the date the work was started or materials were first furnished, or the date work was completed, depending on state law.	T
56. Junior liens are paid after superior liens, and then based on the amount owed.	F
57. Easements are written agreements that allow the use of someone's land.	T
58. An easement by necessity helps a property from becoming landlocked.	T
59. An appurtenant easement is a type of easement that attaches to and runs with the land.	T
60. An easement in gross has a dominant tenement and a servient tenement.	F
61. Tenancy by the entirety is a type of multiple ownership for only married couples.	T
62. A prescriptive easement is obtained through the courts after open, continuous, exclusive, adverse, and notorious use has been proven over a period of time.	T
63. A license is a type of irrevocable use of real property.	F
64. An encroachment would probably be found on title at the county recorder's office.	F
65. A tree limb hanging over a neighbor's property line is an example of an encroachment.	T
66. Legal title may be acquired by a prescriptive easement.	F
67. An easement appurtenant terminates upon the sale of a servient tenement property.	F
68. To run underground utility lines across an owner's property, the utility company must have an easement in gross.	T
69. A roofer has the right to file a mechanic's lien for an unpaid roof replacement invoice and date the lien back to when the supplies were delivered, rather than the date of recording.	T

70. A fee simple absolute has the most bundle of rights and has an indefinite duration.	T
71. A fee simple defeasible has the most bundle of rights and has an indefinite duration.	F
72. A life tenant may sell their life estate.	T
73. Joint Tenancy is the type of concurrent ownership designated only for married couples.	F
74. Sole ownership is a property type of ownership for a corporation.	T
75. An individual would normally take title to a property as estate in severalty.	T
76. Tenancy in common is a type of non-freehold estate.	F

**Answer Key for Chapter 6**

1. Taxation, Escheat, Condemnation and Police Power are the governmental rights of land use control.	F
2. Zoning, building codes, building permits, and certificates of occupancy are under police power.	T
3. If an owner dies intestate and has no heirs, the government power of Eminent Domain is exercised and the property reverts back to the government.	F
4. Condemnation is the process by which the government exercises their right of Eminent Domain.	T
5. The zoning in a neighborhood changed, potentially affecting a local bakery. The local government can allow the bakery to continue its business, but it would be considered a legal non-conforming use.	T
6. A school in a residential neighborhood can exist under a variance.	F
7. Assessed value is the same as fair market value.	F
8. Police Power is the government power that promotes public health, safety, and protection of the public.	T
9. A property tax is based on the market value of the property	F
10. A setback is controlled through zoning ordinances.	T
11. The purpose of zoning laws is to preserve property values.	T
12. A certificate of occupancy must be obtained before beginning construction of a building.	F
13. A certificate of completion is needed prior to occupying a newly constructed building.	F
14. A variance allows a property owner to slightly vary from the current zoning regulations.	T
15. Government buildings, schools, churches and hospitals are exempt from paying property taxes.	T
16. Ad Valorem is determined by multiplying the mill levy/millage rate by the assessed value of the property.	T
17. The millage rate (MILL) is equal to one tenth of one cent (\$0.001).	T
18. Special assessments are levied against the front footage of a property for the purpose of local improvements like sidewalks or streetlights.	T
19. Eminent Domain allows the government to "take" private property for public use for just compensation.	T
20. A buffer zone is used to separate two different adjoining uses.	T
21. Zoning ordinances are used to regulate construction and material standards for buildings.	F
22. Environmental Impact Reports examines the likely environment effects of a project and must be disclosed to all potential buyers.	T
23. Flood plains are areas with a 1% chance of flooding in any given year and may require flood insurance if financing is involved.	T
24. A Master Plan promotes the orderly growth in an area and meets social and economic needs.	T
25. Lead based paint hazards must be disclosed if a property has a building permit issued prior to January 1, 1982.	F
26. Buyers have up to 20 days to have a lead-risk assessment performed on a property, if desired.	F
27. Police Power controls deed restrictions.	F
28. Lead hazards can be found in paint, water and soil.	T

29. Lead hazards must be disclosed for all types of real property.	F
30. Real estate professionals (not sellers) must provide buyers with the federal EPA Lead Hazard pamphlet.	F
31. Mold remediation is the removal of mold issues which left untreated might negatively affect a property's condition and value.	T
32. Private land use controls are enforced by Police Power.	F
33. Deed restrictions are commonly known as covenants.	T
34. Superfund Amendments and Reauthorization Act of 1986 established stronger cleanup standards for contaminated sites.	T
35. High-tension power lines create asbestos, which is suspected of causing cancer and other health concerns.	F
36. The millage breakdown for ad valorem taxes are: library: .5 mills, school: 1 mill, school debt service: .5 mills, community college: 1 mill, vocational school: .5 mills, and all others: 5 mills. A property has an assessed value of \$165,000. The tax bill is \$1,405.75. (Solution: $.5 + 1 + .5 + 1 + .5 + 5 = 8.5$ mills or $.0085$ . $\$165,000 \times .0085 = \$1,402.50$ )	F
37. If the assessed value of a house is \$60,000 and its annual taxes are \$330, taxes on a similar house assessed at \$72,000 would be \$396. (Solution: $\$330 \text{ annual taxes} \div \$60,000 \text{ assessed value} = .0055$ or $5.5$ mills. Next $\$72,000 \times .0055 = \$396$ annual taxes)	T
38. Woodmen Road serves as a major thoroughfare from the town of Falcon to Colorado Springs, however it is woefully inadequate to handle the increased traffic from these growing towns. The city decides to spend \$2,500,000 to increase the road from two lanes to four and install two traffic lights. Current demographics show that 4,567 properties will benefit from the road expansion. Mrs. Bowen lives in Falcon. Her share of this special assessment is \$648. (Solution: $\$2,500,000 \div 4,567 \text{ impacted properties} = \$547.41$ special assessment)	F
39. Mrs. Bowen's property measures 111.3' x 190.7'. The Woodmen Road special assessment is .33 mills per front foot. She pays a special assessment of \$.04. (Solution: $.33 * .001 = .00033$ mill rate. $.00033 \times 111.3 = \$0.036729$ or $$.04$ special assessment)	T

*Answer Key for Chapter 7*

1. An appraisal is an opinion of value.	T
2. Market value is the actual price a property sells for.	F
3. Market price is the most probable price a property will sell for.	F
4. The essential elements of value are Demand, Utility/Usefulness, Stability and Transferability.	F
5. It is important for the appraiser to know the purpose of the appraisal.	T
6. The highest and best use of a property will always be its current or existing use.	F
7. The appraisal reconciliation process may take into consideration all three approaches to value.	T
8. The principle of highest and best use is the most important among all three approaches.	T
9. Land has the possibility of depreciating.	F
10. The sales comparison approach is also known as the market data approach.	T
11. The principle of supply and demand states that if demand increased for a particular product and supply remains constant then prices should increase.	T
12. Using the market data approach, adjustments are made to the subject property.	F
13. The first thing that an appraiser should do when estimating land value is to determine its highest and best use.	T
14. When considering whether building a swimming pool would increase the property value an appraiser would utilize the principles of conformity to help them in their determination.	F
15. When three adjacent properties are combined into one to create a higher value (plottage) than the individual sum of the three properties' values, the process is called assemblage.	T
16. The cost approach is also known as the summation approach.	T
17. If a comparable is better than the subject property, value is added to the comparable property.	F
18. The sales comparison approach relies on the principle of Substitution.	T
19. Progression is the increased worth of a lesser property when located among better properties.	T
20. Regression is the increased worth of a better property when located among worse properties.	F

21. The summation approach is the most reliable approach for special-purpose properties.	T
22. The reproduction cost is the cost to construct an exact replica of the subject's structure.	T
23. Replacement cost is the cost to construct a structure with the similar usefulness/utility.	T
24. The current owner's acquisition cost is taken into consideration by the appraiser in estimating the value of a property.	F
25. The best comparable property for a subject is one that requires the fewest and smallest adjustments be made to it.	T
26. Estimating accrued depreciation is made in the income approach.	F
27. Physical deterioration is loss of value to a property that is beyond normal wear and tear.	T
28. The capitalization approach is also known as the income approach.	T
29. Deferred maintenance is an example of functional obsolescence.	F
30. A five-bedroom, one-bathroom house is an example of external obsolescence.	F
31. Dividing the net operating income into the capitalization rate will be the value of a property in the income approach.	T
32. Assemblage is the process of conjoining adjacent properties which can create a combined value that is greater than the values of the properties individually.	T
33. Plottage is the value of conjoined adjacent properties through the process of Assemblage.	T
34. In the sales comparison approach, the adjustments are made to the subject property.	F
35. In the market data approach, when the comparable is better than the subject, value is added to the comparable.	F
36. In the market data approach, when the comparable is worse than the subject, value is added to the comparable.	T
37. An appraiser will use the summation approach when finding the value of new construction.	T
38. The best comparable property to use is one that requires the most and largest adjustments.	F
39. The capitalization approach will be the best method to use on unimproved land.	F
40. The GRM method of valuation is best used for single family rentals.	T
41. The first step in the appraisal process is to define the purpose of the appraisal.	T
42. When reconciling the appraisal, the appraiser averages all three approaches to value.	F
43. The capitalization approach relies heavily on the Net Operating Income.	T
44. The NOI on an apartment building is \$14,400. With a desired 12% cap rate, the most an investor would pay for the building is \$1,200,000. (Solution: $\$14,400 \text{ NOI} / .12 \text{ cap rate} = \$120,000 \text{ value.}$ )	F
45. A property has a GIM of 15 with a monthly rent of \$1,100. The indicated value of the property would be \$16,500. (Solution: $\text{GIM uses annual income. } \$1,100 \text{ monthly rent} \times 12 \text{ months} = \$13,200 \text{ annual rent income. } \$13,200 \times 15 \text{ GIM} = \$198,000 \text{ property value.}$ )	F
46. Physical deterioration is normally a curable depreciation.	T
47. Economic obsolescence is also known as locational obsolescence and/or external obsolescence.	T
48. Within the income approach, the higher the cap rate, the higher the value.	F
49. A property has a GRM of 150 with a monthly rent of \$3,000. The indicated value of the property would be \$450,000. (Solution: $\$3,000 \text{ monthly rent} \times 150 \text{ GRM} = \$450,000 \text{ property value.}$ )	T
50. A large home surrounded by smaller homes would be concerned over the principle of regression.	T
51. Accrued depreciation is taken into account within the Income Approach.	F
52. The principle of conformity is concerned with a subject property being similar to its surrounding properties and uses.	T
53. The cost approach is the most reliable of the three approaches in appraising existing residential property.	F
54. Debt service is taken into consideration in the NOI when finding the value of a property.	F
55. To find the value of property within the capitalization approach, the NOI must be multiplied by the capitalization rate.	F
56. A Comparative Market Analysis is the same as an appraisal.	F
57. A Competitive Market Analysis can be used in place of an appraisal with a federally related loan.	F

58. The land on which a house was built is worth \$50,000. The house was constructed in 1986 at a cost of \$265,000 and was expected to last 50 years. Using straight-line depreciation, the house depreciated by \$96,600 in 2010. (Solution: cost of the improvement $\$265,000/50$ years of useful life = \$5,300 depreciation per year. $\$5,300 \times 24$ years = \$127,200 loss of value.)	F
59. The land on which a house was built is worth \$50,000. The house was constructed in 1986 at a cost of \$265,000 and was expected to last 50 years. Using straight-line depreciation, the property was worth \$187,800 in 2010. (Solution: cost of the improvement $\$265,000/50$ years of useful life = \$5,300 depreciation per year. $\$5,300 \times 24$ years = \$127,200 loss of value. $\$265,000 - \$127,000 = \$137,800 + \$50,000$ land value = \$187,800.)	T
60. A two-unit apartment building is being appraised. In this neighborhood, the accepted gross rent multiplier is 144. The annual income on the building is \$16,800 (both units rented). The monthly expenses are \$300. Based on the income approach, the estimated market value of the apartment building is \$201,600. (Solution: Monthly rental income is $\$16,800/12 = \$1,400$ . $\$1,400 \times 144$ GRM = \$201,600. Monthly expenses are not included in the calculation.)	T
61. An apartment building has \$65,000 in potential gross annual income. The vacancy rate is estimated at 5%. Total operating expenses are \$29,000. The capitalization rate is 9%. Using the income approach the value of the building is \$392,367. (Solution: $\$65,000 \times .05 = \$3,250$ . $\$65,000$ gross income - \$3,250 vacancy - \$29,000 operating expenses = \$32,750 NOI. $\$32,750 \text{ NOI} / .09$ cap rate = \$363,889 value.)	F
62. Slumlords, LLC owns an apartment building that generated \$60,000 in rental income, \$15,000 in expenses, and \$35,000 in debt service last year. Also, the property appreciated about \$10,000 last year. Last year's cash flow was \$15,000. (Solution: $\$60,000 - \$15,000 - \$35,000 = \$10,000$ . Appreciation is not considered when determining cash flow.)	F
63. A property is being appraised by the cost approach. The appraiser estimates that the land is worth \$10,000 and the replacement cost of the improvements is \$75,000. Total depreciation from all causes is \$7,000. The value assigned is \$82,000. (Solution: $\$75,000 - \$7,000 + \$10,000 = \$78,000$ . Land is never depreciated.)	F
64. An income property recently sold for \$400,00 to an investor who received a 9% return on his investment. An investor who wanted a 12% return on his money would pay \$300,000 for the same property. (Solution: $\$400,000 \times .09 = \$36,000$ NOI. $\$36,000 / .12 = \$300,000$ .)	T
65. A property has been depreciating 3% per year. If it is valued at \$70,000 today, it was worth \$100,000 ten years ago. (Solution: $3\% \times 10$ years = 30% (.30) depreciation. $100\% - 30\% = 70\%$ (.70). $\$70,000 / .70 = \$100,000$ .)	T

Answer Key for Chapter 8

1. A discount point is 1% of the loan amount.	T
2. A discount point reduces the borrower's interest rate and increases the lender's yield.	T
3. The lower the down payment, the higher the risk of foreclosure.	T
4. A promissory note can be used to foreclose upon a property.	F
5. A security instrument can be used to foreclose upon a property.	T
6. The Loan to Value (LTV) ratio shows the relationship between the loan amount and appraised value.	T
7. Mortgage default insurance may be required if the down payment is less than 20%.	T
8. The mortgagor is the lender.	F
9. A deed of trust is a two-party security agreement.	F
10. The promissory note is evidence of the borrower's promise to repay the lender.	T
11. The difference between the property's current loan balance and its current value is known as equity.	T
12. An interest-only loan is also known as a straight loan.	T
13. A partially amortized loan will have a smaller balloon payment than a straight loan but larger than a fully amortized loan.	T
14. A fully amortized loan will have a balloon payment due at the end of its term.	F
15. A negative amortized loan causes the loan balance to increase over the loan's term.	T

16. Adjustable Rate Mortgages (ARMs) allow the lender to change the interest rate at specified intervals and by a specified amount.	T
17. A mortgage is a two-party security instrument.	T
18. The buyer will have legal title with a contract for deed.	F
19. An installment contract is also known as a land contract and/or a contract for deed.	T
20. A blanket mortgage is typically used by a developer to secure a loan on multiple properties.	T
21. PMI (private mortgage insurance) is an insurance policy against an FHA loan.	F
22. MIP (mortgage insurance premium) is an insurance policy against a conventional loan.	F
23. An alienation clause is exercised by the lender when the borrower defaults.	F
24. A due-on-sale clause is also known as an alienation clause.	T
25. A conventional loan is a federally related loan that is not backed by the Federal Housing Authority (FHA) or the Veterans Administration (VA).	T
26. A package mortgage is used to pledge a furnished condominium as collateral.	T
27. Discount points, loan origination fees, loan interest and property taxes are tax deductible.	T
28. Charging an interest rate in excess of statutory limits is called usury.	T
29. Purchase money mortgage is also known as seller financing.	T
30. A vendee has equitable title and the vendor retains legal title with a contract for deed.	T
31. An escrow/reserve account is primarily used for the payment of taxes and mortgage insurance.	T
32. A due on sale clause is exercised by the lender declaring the loan due immediately when the borrower sells and alienates the property.	T
33. An FHA loan is guaranteed by HUD, while a VA loan is insured by VA.	F
34. Hypothecation is when a borrower does not take legal title to the property until their loan is paid in full.	F
35. A lien theory state allows the borrower to retain legal title and the lender to have a non-possessory interest on a pledged property.	T
36. A mortgage broker provides the financing and servicing of a loan.	F
37. A mortgage broker is the intermediary between the borrower and the lender.	T
38. A lender may require PMI on a conventional loan if the down payment is less than 20%.	T
39. An FHA loan allows for a lower down payment than most conventional loans.	T
40. Prepayment penalties are not allowed on FHA or VA loans.	T
41. A VA appraisal is called a Certificate of Reasonable Value (CRV).	T
42. When a mortgage is paid in full, the lender provides a reconveyance deed to the borrower.	F
43. The Truth in Lending Act requires the lender to disclose all transaction closing costs.	F
44. The Equal Credit Opportunity Act protects retired-aged consumers from being discriminated against when applying for a loan.	T
45. The Department of Housing and Urban Development insures FHA approved lenders against loss on defaulted loans.	T
46. The Department of Veterans Administration guarantees VA approved lenders against loss on defaulted loans.	T
47. The Fair Credit Reporting Act requires lenders to provide loan applicants a statement of reason for a loan rejection within 30 days.	F
48. Regulation Z is also known as the Truth in Lending Act.	T

49. Disclosing APR or the full price does not trigger full disclosure per the Truth in Lending Act.	T
50. Regulation Z does allow a borrower the right to cancel or rescind a first mortgage loan to purchase real property.	F
51. The acceleration clause allows the lender to call a loan due immediately when the borrower defaults.	T
52. When a borrower exercises the defeasance clause in his loan, he is said to have paid off and defeated his loan.	T
53. A deed of reconveyance is provided when a deed of trust is paid in full.	T
54. VA loans allow for 100% LTV.	T
55. Because VA does not require down payments, mortgage default insurance is required.	F
56. A qualified non-veteran may assume a VA loan.	T
57. The USDA (United States Department of Agriculture) offer a variety of loan programs to build or improve housing in rural area.	T
58. A construction loan is also known as a take-out loan.	F
59. A construction loan is a short-term loan.	T
60. A mortgagee pays a mortgagor in a reverse mortgage.	T
61. The Closing Disclosure must be provided to the borrower three business days after loan application.	F
62. Regulation Z applies to non-business loans.	T
63. To comply with Regulation Z, finance charges must include interest, loan fees, discount points, service charges, finder's fees, property insurance, credit insurance and must be stated as the APR.	T
64. APR will always be higher than the interest rate.	T
65. Fannie Mae, Ginnie Mae and Freddie Mac are agencies in the secondary market.	T
66. RESPA allows lenders to pay kickbacks to parties that helped the lender obtain a borrower's business.	F
67. A Loan Estimate must be provided to a borrower three business days before closing.	F
68. The Consumer Financial Protection Board (CFPB) has authority to write rules to protect consumers from unfair or deceptive financial products, acts or practices.	T
69. A borrower with an erratic employment history is protected by the Federal Fair Housing Act.	F
70. A judicial foreclosure requires the lender to sue the borrower in a court of law and obtain a judgment and court order to foreclose upon the property and sell it at a public sale.	T
71. A non-judicial foreclosure allows the lender to utilize a public trustee to foreclose and sell the property at a public sale on behalf of the lender due to default.	T
72. The equitable redemption period occurs after the public sale.	F
73. The statutory redemption period occurs after the public sale.	T
74. The winning bidder at the public sale takes immediate possession of the property.	F
75. The borrower can stop the foreclosure before the public sale by becoming current on the loan and paying any fees and penalties.	T
76. The borrower can stop the winning bidder from owning the foreclosed property by paying off the entire loan and paying any fees and penalties.	T
77. If a foreclosed property is sold for less than what is owed on the loan, the lender can file a deficiency judgment to require the borrower to pay the amount still owed.	T
78. A deed in lieu of foreclosure is when the borrower gives the deed to the lender instead of the lender foreclosing upon the borrower.	T
79. All junior lienholders will disappear when a deed in lieu of foreclosure is utilized by the senior lienholder.	F

80. When attempting to sell a property, the borrower may ask the lender to accept less than what is owed on the loan. If the lender accepts an amount less than the loan amount, this process is called a short sale.	T
81. Upon a short sale, the lender may still sue for a deficiency judgment.	T
82. If a lender agrees to make a loan at 95% LTV on a property purchase of \$450,000 where the property appraises for \$445,000. The amount of the loan is \$422,750. <i>(Solution: <math>\\$445,000 \times .95 = \\$422,750</math>)</i>	T
83. A property sells for \$375,000. The borrower puts \$40,000 down. The LTV ratio is 85%. <i>(Solution: loan amount is <math>\\$375,000 - \\$40,000 = \\$335,000</math>. <math>\\$335,000/\\$375,000 = .89333</math> or 89%)</i>	F
84. A borrower paying four (4) discount points on a \$300,000 loan would be charged \$13,000. <i>(Solution: discount point = 1% of loan amount. <math>\\$300,000 \times .01 = \\$3,000 \times 4 = \\$12,000</math>)</i>	F
85. Jane negotiated that the seller would pay two discount points to her lender to reduce her interest rate. Her rate has gone down by ½ a percent. <i>(Solution: 8 points = 1% reduction, so 4 points = ½% reduction)</i>	F
86. Tom's home is worth \$415,000 and he owes \$375,000 on it, so he has \$40,000 in equity. <i>(Solution: <math>\\$415,000 - \\$375,000 = \\$40,000</math>)</i>	T
87. D'Ann purchased her new home on 123 Main Street for \$615,000 using her VA eligibility. Her down payment was probably \$123,000. <i>(Solution: (VA loans are usually \$0 down payment)</i>	F
88. D'Ann purchased her new home on 123 Main Street for \$615,000 using an FHA loan. Her down payment was probably \$21,525. <i>(Solution: FHA requires 3.5% down payment. <math>\\$615,000 \times .035 = \\$21,525</math>)</i>	T
89. D'Ann purchased her new home on 123 Main Street for \$615,000 using a conventional loan that requires 8% down payment or \$45,000. <i>(Solution: <math>\\$615,000 \times .08 = \\$49,200</math>)</i>	F
90. MaryAnne borrows \$250,000 at 7% interest. Her monthly payment is \$1,600, applied first to interest and then principal. Her outstanding balance and the end of two months is \$249,858.34. <i>(Solution: (<math>\\$250,000 \times .07 = \\$17,500</math> annual interest. <math>\\$17,500/12 = \\$1,458.33</math> monthly interest. <math>\\$1600 - \\$1,458.33 = \\$141.67</math> applied towards principal month one. <math>\\$250,000 - \\$141.67 =</math> principal balance of <math>\\$249,858.33</math>. <math>\\$249,858.33 \times .07 = \\$17,490.08/12 = \\$1457.51</math> monthly interest. <math>\\$1600 - 1457.51 = \\$142.49</math> principal reduction. <math>\\$249,858.33 - \\$142.49 = \\$249,715.84</math> outstanding balance at the end of the second month.)</i>	F
	F

Answer Key for Chapter 9

1. For a contract to be enforceable it must be recorded with the recorder's office.	F
2. An executed contract is one that has yet to fully performed.	F
3. There are seven essential elements that makes a valid contract.	F
4. A valid contract requires all parties to be competent, 18, sane and sober.	T
5. A valid contract must have mutual consent, also known as meeting of minds; mutual agreement; or offer and acceptance.	T
6. A valid contract must show consideration, the promise of providing something of value.	T
7. Consideration can be "of love and affection."	T
8. Consideration is anything that a willing buyer is willing to give and a willing seller is willing to receive.	T
9. An essential element of a valid contract is having legal purpose or lawful objective.	T
10. A listing agreement signed by a licensee and Greta, who lives in the house but isn't on the deed, would still meet the essential element of legal purpose if both parties agree.	F
11. A valid real estate contract requires the property's legal description.	T
12. A valid contract must be in writing and signed by all parties to be enforceable in a court of law.	T

13. The Statute of Frauds states that all real estate contracts (even those that don't transfer ownership) must be in writing to be enforceable.	F
14. A contract must be notarized, or acknowledged, for it to be enforceable.	F
15. The purpose of the Statute of Frauds is to avoid a "he said, she said" battle.	T
16. If a contract is missing one or more essential elements, the contract is considered void.	T
17. A void contract cannot be enforced in a court of law.	T
18. A voidable contract appears to be valid but there is an injured or disabled party.	T
19. A party can become injured through duress, fraud, misrepresentation, and being a minor.	T
20. A property's habitability is one of the essential elements of a valid contract.	F
21. A valid contract must have a marketable title.	F
22. The parties to an offer are the offeror and the offeree.	T
23. The offeror is always the buyer, and the offeree is always the seller.	F
24. Once under contract, the seller becomes the vendee and the buyer becomes the vendor.	F
25. During the executory period, the vendor retains legal title and the vendee has equitable title.	T
26. A counteroffer is a partial rejection of the original offer.	F
27. A counteroffer is used during the contract's executory period.	F
28. The vendee's equitable interest prohibits the vendor from selling the property to another party while the contract is in effect.	T
29. All parties agree to act in good faith to perform the terms of the contract.	T
30. Lack of adherence to the contract can cause a party to be in default of the agreement.	T
31. Earnest money is considered actual damages.	F
32. A real estate contract is a unilateral agreement between a buyer and a seller.	F
33. An option is a unilateral agreement between a seller and potential buyer.	T
34. An option is a unilateral contract binding only the potential buyer to purchase the property.	F
35. An amendment would be used during the executory period.	T
36. A long legal description is an example of an attachment that would be provided with the offer.	T
37. Contract obligations are those duties that each party is legally responsible for during the contract period.	T
38. Contract contingency clauses allow a party the right to terminate a contract under certain circumstances, such as being able to be approved for financing.	T
39. If a seller defaults on a contract, the buyer's remedy is limited to liquidated damages.	F
40. A bilateral purchase contract has both a ready, willing, and able buyer and a ready, willing and able seller.	T
41. Real estate contracts are typically express, written agreements.	T
42. A general expressed contract may either be oral or written.	T
43. An implied contract is an agreement demonstrated by actions and conduct.	T
44. An executed contract is a contract that has been fully performed.	T
45. To modify an executory contract, all parties must agree to and sign an addendum.	F

46. An offer becomes a contract with communication of acceptance.	T
47. An offeror is always the buyer, and an offeree is always the seller.	F
48. An offeror may not withdraw an offer and must wait for a response from the offeree.	F
49. If an offeree communicates acceptance of an offer prior to the offeror withdrawing, the offer becomes a valid contract.	T
50. An offer is a unilateral contract until communication of acceptance has been received.	F
51. A counteroffer is a partial acceptance of the original offer.	F
52. Death or incapacitation terminates an offer.	T
53. When a party to a contract fails to perform according to the contract's stipulations, this is considered a breach of contract.	T
54. If a seller is in breach of contract and defaults, the buyer's remedy may be specific performance.	T
55. If a seller is in breach of the contract, the seller may keep the earnest money as liquidated damages or exercise specific performance, whichever was determined as the seller's remedy at the beginning of the executory period.	T
56. If a buyer is in default of the contract, the seller may keep the earnest money as liquidated damages or exercise specific performance, whichever was determined as the seller's remedy at the beginning of the executory period.	T
57. A contract with a minor to purchase vacant land would be considered a void contract.	F
58. A seller determined insane by a court of law would have a voidable purchase contract with the buyer.	F
59. Death of the salesperson terminates a listing contract with a seller.	F
60. A verbal agreement to purchase real estate is an unenforceable contract.	T
61. An injured party has the right to the rescission of a contract.	T
62. Electronic signatures are not considered a legal signature and not enforceable in a court of law.	F
63. An open listing is an example of a bilateral contract.	F
64. A buyer signs an agency agreement that allows him to find and close on a property without the licensee's assistance and not owe a commission. This is an example of a buyer agency exclusive agency.	T
65. The statement "time is of the essence" means that a contract deadline allows for a one-time 24-hour extension.	F
66. If a broker receives multiple offers for a listing, he must show the seller the highest offer before any of the other offers.	F
67. A buyer submits an offer to a seller stating she will buy his property if she can sell her current property. This is an example of a contingency.	T
68. No action is needed to satisfy a contingency.	F
69. An addendum modifies a contract.	F
70. An amendment modifies a contract.	T
71. If a party to an offer dies, the offer remains in place.	F
72. An agent would likely desire a seller to sign an open listing, which limits the amount of competition for the agent to sell the property.	F
73. A listing agreement would be terminated if the property was condemned.	T
74. An Exclusive Right to Sell listing contract allows the seller to sell the property without any obligation to the broker.	F
75. A seller may hire more than one broker to sell his property with a non-exclusive/open listing.	T
76. A net listing states minimum net proceeds the seller desires, and anything above that amount is the broker's commission.	T

*Answer Key for Chapter 10*

1. A property manager is required to hold an active real estate license.	T
2. A property manager is a limited/special agent for the property owner.	F
3. One of the goals of the property manager is to find well-qualified tenants on behalf of the property owner.	T
4. One of the goals of the property manager is to maintain the value of the property on behalf of the property owner.	T
5. A property manager is allowed to make capital improvements on a property on behalf of the property owner.	F
6. As a general agent, a property manager is responsible for financial, physical and administrative services for the principal.	T
7. A property management agreement is the contract used to define the property manager's scope of work and authority.	T
8. Providing financial reports and creating a budget for a leased property is not a responsibility of the property manager.	F
9. Checking a prospective tenant's credit report and criminal background are two of the tasks a property manager would do to find a well-qualified tenant for the property owner.	T
10. A property manager may use the broker's operating account to hold rents and security deposits.	F
11. If a property manager notices the rental vacancy rates are lower than market rates, s/he should consider lowering the rental rates.	F
12. High tenant turnover rates decrease marketing expenses and increases profits.	F
13. A leasehold estate is also known as a non-freehold estate.	T
14. A non-freehold estate shows proof of ownership.	F
15. A non-freehold estate shows proof of possession.	T
16. An estate for years is also known as a tenancy for years and has an expiration/termination date.	T
17. An estate for years can only be used with residential leases.	F
18. A month-to-month lease is an example of an estate for years.	F
19. A periodic estate shows proof of ownership for a defined period of time.	F
20. A periodic estate is also known as a periodic tenancy or tenancy from period to period.	T
21. If a lessee continues to make their periodic payments and the lessor accepts it, the periodic tenancy continues.	T
22. Estate from period to period is common with residential properties.	T
23. There is a definite termination date with a periodic tenancy.	F
24. Death will terminate a tenancy for years.	F
25. Death will terminate an estate from period to period.	F
26. Death will terminate an estate at will.	T
27. A lessor is the tenant and a lessee is the landlord.	F
28. Lessors have leasehold interests in a rental property while lessees have a reversionary interest.	F
29. Lessees have the right of possession and use in real property in exchange for payment of rent.	T
30. A tenancy at will can be an oral lease agreement.	T
31. An estate at sufferance is when the lessee has not vacated the property per the lease agreement and continues to have possession of the property beyond the termination/ expiration date.	T

32. In a gross lease, the tenant pays a fixed rate and the property owner is responsible to pay all property operating expenses.	T
33. A gross lease is typically found in commercial properties.	F
34. A net lease requires a tenant to pay a base rent plus a percentage of the operating expenses.	T
35. A percentage lease requires a tenant to pay a base rent or a portion of their sales income, usually whichever is more.	T
36. A percentage lease is typically found in retail leases.	T
37. A ground lease is also known as a land lease.	T
38. A business owner may want to sell his real estate but continue his right of possession by using a sale leaseback, which allows him to raise his capital and reduce his debt in the business.	T
39. If a tenant builds an improvement on vacant land with a ground lease, at the end of the lease term, the improvement becomes the landlord's property.	T
40. Rent belongs to the lessor, while security deposits belong to the lessee.	T
41. A lease option is the same as an option.	F
42. A lease option can also be known as a rent to own.	T
43. A landlord gives up his right of possession in exchange for rent and has a leased fee estate.	T
44. A lessor has a reversion interest in a property rented to a lessee.	T
45. A lessor may retain the right to enter his leased property for repairs and/or maintenance with notice and consent from the lessee.	T
46. A landlord is expected to keep a leased property in habitable condition in exchange for rent.	T
47. If a lessee has violated their lease agreement, a lessor can exercise constructive eviction.	F
48. If a lessor fails to keep a leased property in habitable condition, the lessee can exercise constructive eviction, but must vacate the property.	T
49. Tenant abandonment of a property terminates an existing lease.	F
50. Security deposits can be withheld for normal wear and tear once the tenant vacates the property.	F
51. A landlord must allow a disabled tenant to make appropriate modification per Federal Fair Housing laws.	T
52. A disabled tenant who makes modifications to a leased property may be asked to pay for the costs to reverse those modifications.	T
53. A landlord must pay for the modification to a leased property on behalf of a disabled tenant.	F
54. The Americans with Disabilities Act (ADA) prohibits discrimination in commercial properties.	T
55. ADA ensures that the disabled have equal access to public accommodations.	T
56. ADA requires accessibility to accommodations be readily achievable to existing properties.	T
57. New construction must meet higher standards for public accommodations when being built than existing properties.	T
58. Adding a ramp to an entrance with stairs is an example of making a readily achievable modification.	T
59. The Equal Credit Opportunity Act (ECOA) allows lenders to discriminate against age and those receiving public assistance.	F
60. ECOA protects against the same classifications as Federal Fair Housing.	F

*Answer Key for Chapter 11*

1. An abstract of title is a collection of legal documents that shows the chronological history of the real property.	T
2. Recording a title document proves it is legal.	F
3. Recording a document provides actual notice.	F
4. A title insurance policy is renewed every five years.	F
5. A title commitment is the same as a title insurance policy.	F
6. A title search must be done for a title commitment to be issued.	T
7. A title search would reveal an encroachment.	F
8. A title search would reveal a recorded easement.	T
9. A title search would reveal parties in possession.	F
10. Commingling is mixing of trust funds with the broker's operating funds.	T
11. Conversion is the act of using a client's earnest money funds to pay the brokerage firm's utility bill.	T
12. A trust account is also known as an escrow account.	T
13. A trust account is used to run the brokerage firm's business activities.	F
14. A trust account is used when holding monies belonging to others.	T
15. Being found guilty of commingling or conversion can lead to license discipline.	T
16. There are two types of title policies; owner's title policies and mortgagee's title policies.	T
17. There are two types of title coverages; standard coverage and owner's extended coverage.	T
18. The purpose of title insurance is to protect the insured party against loss resulting from certain title defects.	T
19. Standard coverage will protect against an undisclosed mechanic's lien.	F
20. The process of investigating public records to find any existing title defects on title is called chain of title.	F
21. The chronological history of all of the property's title records affecting rights and interests in the property is known as chain of title.	T
22. Title passes in The Torrens System when the transfer has been registered on the Torrens Certificate.	T
23. A chain of title can identify any breaks or gaps in the chain of ownership to a property.	T
24. A marketable title is also known as a merchantable title and is free and clear from defects to a property.	T
25. A title commitment is a binding agreement to provide a title insurance policy at or after closing.	T
26. An encroachment would be found in a title search.	F
27. An encroachment would be found in a survey.	T
28. A title defect found before closing will be covered by the title insurance policy.	F
29. A title defect found after closing will be covered by the title insurance policy.	T
30. A defect on title must be cured before a seller can convey marketable title.	T
31. An abstract guarantees merchantable title.	F
32. Clerical or filing errors never happen with public records.	F
33. A cloud on title is a title defect found in public records.	T

34. A suit to quiet title, also known as a quiet title suit, is a court action to cure a cloud on title or gap in the chain of title.	T
35. Taxation on capital gains taxes can be deferred by using a 1031 exchange.	T
36. A closing/settlement statement will show commissions split between the broker and salesperson.	F
37. The loan payoff will show up on the buyer's closing statement.	F
38. The earnest money will show up on the buyer's settlement statement.	T
39. The notary fee for the mortgage or deed of trust will show up on the seller's closing statement.	F
40. A debit is a charge to the responsible party for an expense.	T
41. The seller's largest credit is the purchase price.	T
42. The earnest money is a buyer debit on the buyer's closing statement.	F
43. A VA loan is always a buyer debit.	F
44. Security deposits are prorated between the seller and the buyer.	F
45. Prorations are done using a 360-day year, 30-day month, and the seller owning on the day of closing.	T
46. When prorating real property taxes of \$1,800 (paid in arrears) with a closing date of August 15, the seller will be debited \$1,125. <i>Solution: <math>\\$1,800/360 = \\$5/\text{day}</math>. Seller Owes Buyer for 225 days. <math>225 \times \\$5 = \\$1,125</math>. Debit the seller \$1,125, credit the buyer \$1,125.</i>	T
47. To avoid capital gains tax, the seller must have lived in the property 3 out of the last 5 years.	F
48. The first \$250,000 (single) or \$500,000 (married) of proceeds may be excluded from capital gains tax for a principal residence.	T
49. The 1031 Exchange helps an investor eliminate paying taxes on their capital gains.	F
50. TRID requires the lender use the Loan Estimate and the Closing Disclosure.	T
51. The Loan Estimate must be delivered to the buyer no later than 3 business days after loan application.	T
52. Buyer must receive the Closing Disclosure at least 3 business days before closing.	T
53. Saturday is not considered a business day for the Closing Disclosure.	F
54. A seller received a rental payment of \$100 in advance. At closing, the seller has "earned" only \$32 of this rent. The closing statement shows a debit to the seller for \$32 and a credit to the buyer for \$100. <i>Solution: Debit the seller and credit the buyer \$68.</i>	F
55. A sale is to be closed on April 15. Real estate taxes for the current year are \$1860 and have not been paid. The proration will be \$1317.49 credit to the buyer. <i>Solution: <math>1860/360 = \\$5.1667</math> per day. Seller owns the house for 105 days. <math>\\$5.1667 \times 105 = \\$542.50</math>.</i>	F
56. Greg sold his house for \$450,000. He agreed to pay his broker 7% of the sale price. Greg has a remaining balance of \$315,000 on his mortgage and also agreed to pay \$2,700 to repair his back deck. The owner's title insurance policy costs \$1,000 and Greg's portion of the real property taxes for the current year are \$890. The closing services fee of \$400 will be split equally between the buyer and the seller. Greg's net proceeds are \$98,710. <i>Solution: <math>450,000 \times .07 = \\$31,500</math>. <math>\\$450,000 - 31,500 - \\$315,000 - \\$2,700 - \\$1,000 - \\$890 - \\$200 = \\$98,710</math>.</i>	T
57. In one state, the transfer tax is \$1.20 for each \$300 (or fraction of \$300) of the sales price of any parcel of real estate. If a seller's property sold for \$250,000, the transfer tax will be \$1,000. <i>Solution: <math>\\$250,000/300 = 833.33 \times \\$1.20 = \\$1,000</math>.</i>	T



## Appendix B - Index

### 1

1031 property exchange, 324

### A

absorption, 164  
abstract, 315  
acceleration clause, 221  
accessibility, 49, 53, 285  
accretion, 74  
acknowledgment, 105  
actual eviction, 283  
ad valorem taxes, 140, 144  
addenda, 252  
adjustable rate mortgage, 213  
adverse material facts, 30  
adverse possession, 122  
advertising, 9, 34, 54, 226  
advisory services, 9  
Affiliated Business Arrangement, 307  
affixed, 90  
agency, 6, 11, 26-36  
agent, 6, 25-36  
air rights, 72, 114  
alienation, 122  
alienation clause, 204  
allocation of customers, 55  
allocation of markets, 55  
amendment, 137, 253  
American Society of Home Inspectors, 3  
Americans with Disabilities Act (ADA), 52, 284  
amortized, 200, 206, 208, 213  
annexation, 91  
annual percentage rate (APR), 226  
anticipation, 164  
Antitrust laws, 54-55  
appraisal, 166  
appraiser, 1, 85, 166, 168  
appreciation, 173, 201  
area, 85-90  
ARM. *See* adjustable rate mortgage  
arm's length transaction, 168  
asbestos, 58, 146-147  
assemblage, 166  
assessed value, 139-143  
assumable loan, 211  
attorney-in-fact, 27  
avulsion, 74

### B

balloon payment, 199, 213  
bargain and sale deed, 104  
base employment, 162  
base lines, 79

beach nourishment, 146  
beneficiary, 109, 202, 222  
bilateral, 248  
bill of sale, 92  
blanket mortgage, 215  
blockbusting, 48  
borrower, 215  
boycotting, 55  
bridge loan, 214  
broker, 4  
    supervision, 8  
    training, 8  
Broker Price Opinion (BPO), 187  
broker's license, 6  
brokerage cooperation, 11  
brokerage firm, 7  
brokerage services, 9  
buffer zone, 136  
building codes, 138  
building permit, 138  
business opportunity, 10  
business trust, 6  
buydown loan, 213

### C

CAN-SPAM Act, 54  
cap rate. *See* capitalization rate  
capital gains tax, 323  
capital improvements, 136, 276,  
capitalization rate, 178  
carbon monoxide, 58, 146  
cash flow, 176, 276  
CC&Rs. *See* covenants, conditions and  
    restrictions  
CERCLA, 148  
Certificate of Occupancy, 138  
Certificate of Purchase, 222  
Certificate of Reasonable Value (CRV), 212  
chain of ownership, 105  
change, 165  
chattels. *See* personal property  
circle formula  
    AMT, 141  
    AperB, 173  
    CRISP, 13  
    IRP, 205  
    IRV, 178  
    TAM, 141  
Civil Rights Act of 1866, 46  
client, 26  
client listing, 8  
closing agent, 299  
Closing Disclosure, 217, 106, 138  
closing in escrow, 300  
closing instructions, 300  
cloud on the title, 316  
coastal land, 146  
Code of Ethics, 3  
color, 46-47  
commercial real estate, 4  
commingling, 317  
commissions, 10-12  
common interest ownership, 114  
common law of agency, 26  
community property, 110  
comparable property, 168  
Comparative Market Analysis (CMA), 187  
compensation, 10  
competent parties, 245  
Competitive Market Analysis (CMA). *See*  
    Comparative Market Analysis (CMA)  
Comps. *See*  
    Comparable property  
condemnation, 138  
conditional use, 137  
condominium, 114  
condominium by-laws, 114  
condominium declaration, 114  
conformity, 165  
consideration, 245  
construction loan, 214  
constructive eviction, 284  
constructive notice, 105, 307  
Consumer Financial Protection Bureau  
    (CFPB), 217  
contingency, 252  
continuing education, 2  
contract for deed, 214, 255  
contribution, 165  
conventional life estate, 107  
conventional loan, 210  
conversion, 317  
conveyance deed. *See* deed  
cooperative, 115  
corporation, 5, 110,  
    corporation (for profit), 5  
    corporation (not for profit), 5  
corrective maintenance, 278  
cost approach, 171  
counteroffer, 250  
covenants, 149  
covenants, conditions and restrictions, 149  
credit, 215-217  
credit report, 215-217  
curtesy, 108  
customer, 33

### D

datum, 85  
debit, 317  
debt ratio, 216  
debt-to-income ratio, 216  
deed, 102  
deed conditions, 149  
deed in lieu of foreclosure, 222  
deed of trust, 201  
deed restrictions, 142  
defeasance, 203

deficiency judgement, 222  
delivery and acceptance, 105  
demand, 159  
Department of Housing and Urban  
Development (HUD), 211  
Department of Veterans Affairs, 211  
depreciation, 167, 172, 173  
designated agency, 33  
designated agent, 32  
devisee, 145  
devisor, 145  
disclosed dual agency, 32  
discount rate, 223  
discrimination, 46  
ditch rights, 74  
Doctrine of Prior Appropriation, 74  
dominant tenement, 119  
Do-Not-Call list, 54  
dower, 108  
down payment, 199-201, 209, 211  
down payment assistance, 212  
dual agency, 31  
due on sale clause, 204

## E

earnest money, 252, 316, 319  
easement, 118  
easement appurtenant, 118  
easement by necessity, 119  
easement by prescription, 120  
easement in gross, 120  
economic (external) obsolescence, 172  
economic characteristics of land, 74  
economic life, 166, 172  
economics, 159  
effective gross income, 177  
egress, 120  
elective share, 108  
electromagnetic field, 147  
electronic signature, 251  
emblems, 91  
EMF. *See* electromagnetic field  
eminent domain, 122, 135, 138  
employee, 7  
taxes, 7  
employer broker, 8  
employing broker, 4, 7  
encapsulation, 58  
encroachment, 121  
encumbrance, 115  
enforceable, 28, 247  
environmental hazards, 57, 146-147  
environmental impact reports, 145  
Environmental Protection Agency, 146  
Equal Credit Opportunity Act, 52, 227,  
285  
Equal Housing Opportunity poster, 46  
equilibrium, 163  
equitable redemption, 222  
equitable title, 116, 201, 249

equity, 201  
erosion, 74  
escheat, 135, 145  
escrow account, 252, 316  
escrow officer. *See* closing agent  
estate at sufferance, 280  
estate at will, 279  
estate for years, 279  
estate from period to period, 279  
estate in land, 106  
estate in severalty. *See* tenancy in  
severalty  
Exclusive Agency, 257  
Exclusive Right-to-Buy, 256  
Exclusive Right-to-Sell, 256  
executory contract, 249  
express agency, 28  
expressed contract, 248  
extended title insurance coverage, 307

## F

facilitator. *See* nonagency  
Fair Housing Act, 46  
familial status, 47  
Fannie Mae (FNMA), 215, 224-225  
Federal Emergency Management  
Agency (FEMA), 146  
Federal Housing Authority, 200, 211  
Federal Reserve System, 223  
fee simple, 107  
fee simple absolute, 107  
fee simple defeasible, 107  
fee simple defeasible condition  
subsequent, 107  
fee simple defeasible determinable, 107  
FHA. *See* Federal Housing Authority  
FHA loan, 211  
FICO score, 217  
fiduciary, 29  
fiduciary duties, 29, 32  
FIRREA, 168  
fixed expenses, 176  
fixture, 91  
flood insurance, 146  
flood plain, 146  
flood zones, 146  
foreclosure, 221  
fraud, 34  
Freddie Mac (FHLMC), 225  
freehold estate. *See* estate in land  
front footage, 144  
functional obsolescence, 172

## G

gap loan. *See* bridge loan  
gender, 47  
general agent, 27, 276  
general lien, 117

general partnership, 5, 109  
general warranty deed, 103  
gift money, 217  
Ginnie Mae (GNMA), 225  
good consideration, 245  
good faith, 247  
good funds, 317  
grantee, 102  
granting clause, 104  
grantor, 102  
gross commission income, 12  
Gross Income Multiplier (GIM), 182  
gross lease, 280  
Gross Rent Multiplier (GRM), 181  
ground lease, 281  
groundwater, 147

## H

habendum clause, 105  
handicap, 47  
hazardous waste sites, 148  
heir, 145  
HELOC. *See* Home Equity Line of Credit  
herbicides, 147  
highest and best use, 165  
Home Equity Line of Credit, 214, 226  
home inspection, 56  
home warranty, 60  
homeowner's insurance, 60, 208, 217  
homeowners association (HOA), 114  
homestead, 108, 139  
Housing and Community Development  
Act, 46  
hypothecation, 201

## I

illiquid, 163  
implied agency, 28  
implied contract, 248  
implied dual agency, 32  
impound account. *See* escrow account  
improvement, 75  
imputed knowledge, 32  
income approach, 176  
steps, 177  
income ratio, 216  
independent contractor, 7  
individual building manager, 275  
individual property manager, 275  
ingress, 120  
innocent landowner immunity, 148  
installment loan. *See* contract for deed  
insurable title, 315  
intentional misrepresentation, 34  
interest, 200  
interest only loan, 213  
interest rate, 204  
intestate, 135, 145

inverse condemnation, 138  
involuntary lien, 116

## J

joint tenancy, 112  
joint venture, 6  
judicial foreclosure, 221  
junior lien, 117

## K

kickbacks, 226

## L

labor, 163  
land, 71  
land lease. *See* ground lease  
land use, 136  
landfill, 147  
last will and testament. *See* will  
latent (hidden) defects, 56  
laws of descent, 107, 145  
lead, 146  
lead hazard pamphlet, 147  
lead-based paint, 146  
lead-based paint disclosure, 146  
leased fee estate, 278  
leasehold estate, 278  
legal description, 76,  
legal life estates, 108  
legal purpose, 246  
legal title, 115, 201  
lender, 201  
lessee, 278  
lessor, 278  
license, 60  
license law, 121  
licensee, 25  
lien, 115  
lien priority, 117  
lien theory, 115, 201  
life estate, 107  
life tenant, 107  
limited agent. *See* special agent  
Limited Liability Company (LLC), 110  
limited partnership, 5, 109  
liquidated damages, 253  
listing brokerage firm, 11  
listing contract, 256  
littoral, 73  
living trust, 109  
loan, 200  
loan amount, 200  
loan application, 215  
loan commitment, 221  
Loan Estimate, 217, 301  
loan servicing, 224  
loan term, 202

loan to value, 200  
lot and block, 84  
LTV. *See* loan to value

## M

management agreement, 276  
market data approach. *See* sales  
comparison approach  
market value, 166  
marketable title, 315  
master plan, 136  
material fact, 56  
measuring life, 107  
mechanic's lien, 118  
Megan's Law, 57  
meridians, 79  
metes and bounds, 76  
mill rate. *See* millage rate  
mills. *See* millage rate  
MIP. *See* Mortgage Insurance Premium  
modifications, 49  
mold, 58, 147  
mortgage, 201  
mortgage banker, 223  
mortgage brokers, 223  
mortgage factor chart, 208  
mortgage fraud, 227  
mortgage insurance premium, 211  
mortgage-backed securities, 225  
mortgagee, 202  
mortgagee's title insurance policy, 307  
mortgagor, 202,  
Multiple Listing Service (MLS), 11  
mutual consent, 245

## N

National Association of Home Builders,  
3  
National Association of REALTORS®, 3,  
25  
national origin, 47  
negative amortization, 213  
negligent misrepresentation, 34  
net lease, 280  
net listing, 257  
net operating income, 176  
non-agency, 35  
non-conforming use, 136,  
non-judicial foreclosure, 222  
notice (of acceptance), 249

## O

offer, 249  
offeree, 249  
offeror, 249  
open listing, 257  
operating budget, 276

operating expenses, 176  
option contract, 248  
origination fee, 211, 226, 301  
owner, 4  
owner's title insurance policy, 307  
ownership rights, 102

## P

P&I payment, 206  
package loan, 214  
partially amortized, 213  
party wall, 119  
payoff statement, 300  
PCB, 147  
percentage lease, 280  
periodic tenancy. *See* estate from  
period to period  
permanent loan, 214  
personal property, 90  
personal service contract. *See* listing  
contract  
pest infestations, 58  
pesticides, 147  
physical characteristics of land, 168  
physical deterioration, 172  
PITI payment, 209  
planned unit development (PUD), 136  
plottage, 166  
PMI. *See* Private Mortgage Insurance  
points, 209  
police power, 65  
policy and procedures manuals, 8  
portfolio loans, 224  
possession, 106  
potential gross income, 177  
Power of Attorney, 27  
power-of-sale clause, 221  
predatory lending, 227  
prepayment, 203  
pre-payment penalty, 212, 213, 221  
preventive maintenance, 278  
price, 159  
price fixing, 55  
primary mortgage market, 223  
principal, 5, 26, 204  
private mortgage insurance, 209  
private trustee, 202  
progression, 165  
promissory note, 202  
property taxes, 117, 144  
proprietary lease, 115  
proration, 320  
protected class, 46  
public trustee, 202  
puffing, 34  
Pur Autre Vie, 108  
purchase money mortgage, 214  
purchase price, 200

## Q

qualified mortgage, 227  
quiet enjoyment, 283  
quiet title suit. *See* suit to quiet title  
quitclaim deed, 104

## R

race, 47  
radon, 58, 147  
ranges, 81  
rate of return (ROI), 178  
real estate, 101  
real estate investment trust, 6  
Real Estate Settlement Procedures Act, 226  
real property, 101  
REALTOR®, 25  
reasonably achievable accommodations, 284  
reconciliation, 183  
reconveyance deed, 204  
recorded plat. *See* lot and block rectangular/government survey, 79  
redlining, 48  
refinance, 226  
regression, 165  
Regulation Z, 225  
release deed. *See* reconveyance deed  
release of mortgage, 204  
religion, 47  
remainderman, 107  
rentable square footage, 85  
rental rate, 167  
replacement cost, 171  
replacement value, 167  
reproduction cost, 171  
reproduction value, 167  
resident manager, 275  
residential real estate, 4  
RESPA. *See* Real Estate Settlement Procedures Act  
responsible broker, 4  
revenue, 139, 177, 280  
reverse annuity loan, 214  
reversion interest, 278  
reversionary interest, 107  
right of first refusal, 114  
right of survivorship, 110  
riparian, 72  
routine maintenance, 278

## S

sale leaseback, 281  
sales comparison approach, 168  
salesperson, 4, 6, 7  
satisfaction of mortgage. *See* release of mortgage

school section, 81  
secondary mortgage market, 224  
sections, 81  
securities license, 115  
security deposit, 281  
seisin, 103  
seller financing, 214  
seller net proceeds, 318  
selling brokerage firm, 11  
separate property, 114  
septic tank, 59  
service animal, 53  
servient tenement, 119  
setback, 137, 149  
settlement statement, 317  
severance, 92  
Sherman Anti-Trust Act, 54  
short sale, 223  
sidewalk, 89  
single agency, 31  
situs, 75  
sole proprietorship, 5  
special agent, 27  
special assessments, 144  
special exception, 137  
special purpose, 3  
special warranty deed, 104  
specialization, 2  
specific lien, 117  
specific performance, 253  
standard title insurance coverage, 307  
Statute of Frauds, 28, 247, 249  
statutory, 117  
statutory redemption, 222  
steering, 48  
stigmatized property, 57  
straight loan. *See* interest only loan  
straight-line depreciation, 172  
strict foreclosure, 222  
subagent, 6, 32  
subject property, 168  
substitution, 165  
subsurface, 71  
subsurface rights, 71  
suit to quiet title, 104, 316  
Superfund, 148  
superior lien, 117  
supply, 159

## T

table closing, 300  
take out loan. *See* permanent loan  
tax certificate, 144  
tax deed, 144  
tax rate, 139  
tax ratio, 140  
taxation, 135  
telemarketing, 54  
Telephone Consumer Protection Act, 54  
tenancy, 109

tenancy at will. *See* estate at will  
tenancy by the entireties, 113  
tenancy for years. *See* estate for years  
tenancy in severalty, 109  
tenants in common, 110  
testamentary trust, 109  
The Appraisal Institute, 3  
tie-in agreements, 55  
tiers, 81  
TILA – RESPA Integrated Disclosure (TRID) rule, 301  
time-share, 115  
title, 102  
title commitment, 308  
title insurance, 307  
title search, 308  
title theory, 116, 201  
Torrens System, 315  
total employment, 162  
township, 81  
trade fixtures, 90  
trade organizations, 3  
trading, 9  
transaction broker. *See* nonagency  
transfer fees, 324  
treasurer's deed, 144, 222  
trust, 109  
trust deed. *See* deed of trust  
trustee, 109, 202  
trustor, 109, 202  
Truth in Lending Act (TILA), 225

## U

underground storage tanks, 147  
underwriter, 216, 221  
undivided interest, 110  
unilateral, 248  
unities of title, 112  
universal agent, 27  
unrepresented. *See* customer  
urea-formaldehyde foam insulation, 147  
usable square footage, 85  
USDA loan, 212  
usury, 204

## V

VA funding fee, 212  
VA loan, 211  
vacancy, 164  
vacancy rate, 277  
valid, 245  
valuable consideration, 245  
value, 166  
variable expenses, 176  
variable interest rate, 213  
variance, 137  
vendee, 255  
vendor, 255

visual inspection, 56  
void, 246  
voidable, 246  
voluntary lien, 116

## **W**

walkthrough, 300  
Waste-disposal sites, 147  
water rights, 72  
wetlands, 145  
will, 145  
Women's Council of REALTORS®, 3  
wraparound loan, 213

## **Z**

zoning, 136  
zoning amendment, 137  
zoning appeals, 136  
zoning laws, 136  
zoning ordinance, 136

## Appendix C – Chart of -ee/or Words

Root Word	-ee or Rec “ee” ver	-or or Giv “or”
<b>Grant</b> – to transfer ownership	Grantee (buyer)	Grantor (seller)
<b>Lease</b> – to give up the right of possession and use to another	Lessee (tenant)	Lessor (landlord)
<b>Mortgage</b> – document that creates a financial lien on a property, pledging the real property as collateral for the debt	Mortgagee (lender)	Mortgagor (borrower)
<b>Deed of Trust</b> – document that conveys title from the trustor to the trustee, who holds title on behalf of a beneficiary. Creates a financial lien on a property that pledges the real property as collateral for the debt.	Trustee (public or private third party that holds title on behalf of the lender [beneficiary] until the debt is repaid.)  A public trustee is either an elected or appointed county government position. An attorney can act as a private trustee.	Trustor (borrower)
<b>Devise</b> – voluntarily transfer real property through a will	Devisee (receiver of real property)	Devisor (deceased)
<b>Offer</b> – to propose contract terms and an intention to enter into a contract. In the event of a <b>counterproposal</b> , the positions switch; the seller becomes the offeror while the buyer is the offeree.	Offeree (seller)	Offeror (buyer)
<b>Vend</b> – to sell. Terms used to describe the parties in a contract for deed or installment loan.	Vendee (buyer)	Vendor (seller)
<b>Option</b> – contract in which the seller agrees to not sell to anyone else within a specific period of time for a price.	Optionee (prospective buyer)	Optionor (owner)