Real Estate Fundamentals

Course Outline

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Chapter 1
Introduction to the Real Estate Business

LECTURE OUTLINE:

I. Real Estate Specialization
   A. Brokerage—the business of bringing people together in a real estate transaction
   B. Appraisal—the process of estimating the market value of real property
   C. Property management—the business of managing real estate to protect the owner's investment and maximize the owner's return
   D. Financing—the business of arranging for or providing funds for real estate transactions
   E. Subdivision and development—the activities of splitting a large parcel of real estate into smaller ones and constructing improvements on the land
   F. Home inspection—the activities involved in conducting a visual survey of a property’s site conditions, structure, and systems and preparing an analytical report useful to both buyers and homeowners
   G. Counseling—the activity of providing clients with competent and independent information and advice to assist in their real estate investment decisions
   H. Education—the provision of real estate education opportunities both to practitioners and consumers
   I. Others—settings in which real estate expertise is required, such as the practice of law, corporations with extensive land holdings, and government agencies

II. Professional Organizations
   A. National Association of REALTORS® (NAR)
      Largest trade organization, comprises state, regional, and local associations
   B. National Association of Real Estate Brokers (NAREB)
   C. Appraisal Institute
   D. American Society of Appraisers (ASA)
   E. National Association of Independent Fee Appraisers (NAIFA)
   F. Real Estate Educators Association (REEA)
   G. Real Estate Buyer’s Agent Council (REBAC)
   H. National Association of Exclusive Buyer's Agents (NAEBA)
I. Building Owners and Managers Association (BOMA)
J. Institute of Real Estate Management (IREM)
K. Commercial Investment Real Estate Institute (CIREI)
L. American Society of Real Estate Counselors (ASREC)
M. American Society of Home Inspectors (ASHI)

III. Types of Real Estate
A. Residential—single-family dwellings, duplexes and double houses, triplexes, fourplexes, apartments, townhouses, condominiums, mobile homes, manufactured housing, modular housing, and real estate used for specific residential purposes such as retirement homes, vacation property, and others common in different parts of the country
B. Commercial—office buildings, retail stores and shopping centers, and other specialized facilities such as marinas, air parks, and certain mixed-use properties
C. Industrial—factories, industrial parks, warehouses, and power plants
D. Agricultural—farms, ranches, orchards, vineyards, feedlots, hatcheries, and timberland
E. Special purpose—churches, schools, cemeteries, government-owned property
F. Separate markets for each type of property
   1. Sale market—where ownership is transferred from seller to buyer
   2. Rental market—where rights to occupy and enjoy a designated portion of the real estate are transferred from the landlord to the tenant for a certain period of time
   3. In Practice: Specialization within real estate firms

IV. The Real Estate Market
A. Market—specific place or economic system where goods are bought and sold
B. Supply and demand—the economic forces that set prices for products.
   1. Characteristics of real estate affecting supply and demand are
      a. uniqueness,
      b. immobility, and
      c. effect of natural disasters or changes in financial markets or local events.
   2. Prices will generally drop as supply increases relative to demand.
   3. Prices will generally rise as demand increases relative to supply.
C. Factors affecting supply:

1. Labor force
2. Construction costs
3. Government controls at all levels
4. Government fiscal and monetary policies

D. Factors affecting demand:

1. Population
2. Demographics—the make-up of the population including mobility, financial stability, and size and nature of family unit
3. Employment and wage levels—where and how money is spent; perceived job security
Chapter 2
Real Property and the Law

LECTURE OUTLINE:

I. Definitions

A. Land—the earth's surface extending downward to the center of the earth and upward to infinity, including things permanently attached by nature, such as trees and water

B. Real estate—the land and all things permanently attached to it by either nature or by man (improvements)

C. Real property—real estate plus the interests, benefits, and rights inherent in the ownership of real estate
   In Practice: "real estate" and "realty" are casual uses of the term accurately described as "real property"

1. Ownership of real property / bundle of legal rights; concept comes from old English law
   2. The bundle of legal rights includes the rights of:
      a. Possession—the right to occupy the premises
      b. Control—the right to determine certain interests for others
      c. Enjoyment—possession without harassment or interference
      d. Exclusion—legally refusing to create interests for others
      e. Disposition—determining how the property will be disposed of
      f. Encumbrance—the right to use property as security for loan

D. Surface rights—may be sold or leased to others

E. Subsurface rights—includes rights to minerals and other substances in the ground. Such rights may be sold or leased to others in the same manner as surface rights and independent of surface ownership.

F. Air rights may also be sold or leased independent of surface ownership. Solar or sun rights have become an ownership issue in recent years primarily because of solar energy applications that require direct access to sunlight.

G. Personal property—all property that does not fit the definition of real property
   1. Movable characteristic; also referred to as chattels
   2. An item of real property may be changed to personal property through severance.
      a. Trees, perennial shrubbery, and grasses not requiring annual cultivation are real property (fructus naturales).
      b. Crops with a growing season of less than a year (annuals), known as emblems, are personal property (fructus Industriales).
   3. An item of personal property may become real estate by annexation.
      a. Construction materials routinely become real estate.
b. Mobile homes, manufactured housing, and modular housing laws vary depending on when and how the housing is permanently attached to the ground.

H. Classification of fixtures

1. Fixture—an article that was once personal property but has been so affixed to land or a building that the law now recognizes it as part of the real property
2. Legal tests of a fixture: overall test is intention of the annexer (Figure 2.4)
   a. The method of annexation
   b. The adaptation to real estate
   c. The existence of an agreement
3. Trade fixture—an article owned by a tenant and attached to rented space or a building for use in operating a business
   a. Tenant’s personal property
   b. Must remove on or before last day of lease
   c. Not removed—becomes landlord’s real property
4. Importance in a real estate transaction—to avoid confusion about which items are intended to be included in the sale, they should be clarified when a property is listed and the sales agreement is negotiated,

II. Characteristics of Real Property that Affect Its Nature and Use

A. Economic characteristics (SIPL)

1. Scarcity: Although the total supply of land is not in short supply, land of a particular quality or location may be limited.
2. Improvements: They can affect both the improved parcel and surrounding parcels, either favorably or unfavorably.
3. Permanence of investment: Improvements are considered to create fixed investments.
4. Location: Peoples’ choices of one area or site over another (preference or situs) are the most important economic characteristic.

B. Physical characteristics (IIU)

1. Immobile: The geographic location of any given parcel of land can never be changed.
2. Indestructible: Land is durable and indestructible, even though erosion, flood, volcanic action, and fire may change its topography and value.
3. Unique: The law holds that no two parcels of land are exactly the same; this uniqueness is also known as "nonhomogeneity" or "heterogeneity."
Chapter 3
Concepts of Home Ownership

LECTURE OUTLINE:

I. Home Ownership

A. Reasons
   1. Sign of financial stability
   2. Investment—appreciation/depreciation, income tax deduction/exclusion of gain from tax for many homeowners
   3. Intangible benefits

B. Many different types of homebuyers—single, married couple with children, “empty nesters”

C. Types of housing—emphasize those that are available in your area
   1. Single-family detached dwellings—a concept that is declining in the newer developments in some areas
   2. Apartment complexes—including low-rise and high-rise buildings, many with swimming pools, clubhouses, golf courses, and tennis courts
   3. Condominiums and cooperatives—for those who want to own their own housing but do not want the responsibility for caring for or maintaining its exterior
   4. Planned unit developments (“PUDs”)—diverse uses in one development
   5. Converted-use properties—existing structures converted into residential use that provide opportunities for greater creativity in the design and use of interior space
   6. Retirement communities—including facilities particularly suited for senior citizens. Fair housing laws establish certain requirements that must be met for these complexes to exclude families with children.
   7. High-rise developments—including residential space, parking, retail shopping, personal service business, and other amenities; generally found in large cities
   8. Manufactured housing (mobile homes)—usually found in a park-like setting with varied amenities
   9. Modular homes—known also as prefabricated homes, preassembled structures placed on a building site; some assembled on-site rather than preassembled; another growing segment of the housing market
   10. Time-shares—shared ownership of a vacation home, with varied popularity

II. Housing Affordability

A. Mortgage terms, including types of loans, their availability, interest rates, and monthly payments
   1. Ownership expenses, such as insurance, real estate taxes, utilities, and maintenance
   2. Ability to meet mortgage payments—the most important economic consideration
   3. Calculating affordability for homebuyers
B. Investment considerations

1. Tax benefits for homeowners
   a. Income tax deductions
      (1) Mortgage interest on first and second homes
      (2) Real estate taxes
      (3) Certain loan origination fees
      (4) Some loan discount points
      (5) Loan prepayment penalties

2. Capital gain: profit realized from sale
   a. Exclusion of $250,000 gain ($500,000 for married couples) from tax on
      sale of residence
   b. Must have lived there two of last five years
   c. Can be used repeatedly
   d. basis, adjusted basis, and boot

3. In Practice: Real estate practitioners should tell their clients and customers to consult with experts for tax advice.

III. Homeowners' Insurance

A. Coverage and claims

1. Basic form policy—provides coverage against fire or lightning, glass breakage, windstorm and hail, explosion, riot and civil commotion, damage by aircraft, damage from vehicles, damage from smoke, vandalism and malicious mischief, theft and loss of property removed from the premises when endangered by fire or other perils

2. Broad-form policy—also covers falling objects; weight of ice, snow, or sleet; collapse of all or part of the building; bursting, cracking, burning, or bulging of a steam or hot water heating system; accidental discharge, leakage, or overflow of water or steam from within a plumbing, heating, or air conditioning system; freezing of plumbing, heating, or air conditioning system; injury to electrical appliances, devices, fixtures, and wiring from short circuits or other accidentally generated currents

3. Further coverage available from policies that cover almost all possible perils

4. Coverage for condominium owners and apartment renters—covers the unit and its contents but not the structure

5. Most policies have a coinsurance clause.
   a. Most require insurance of at least 80 percent of the replacement cost of the structure.
   b. Loss settlement either for actual cash value (replacement cost less depreciation) or prorated by dividing by the percentage of replacement cost actually covered by policy.

B. Federal Flood Insurance Program

1. Administered by the Federal Emergency Management Agency (FEMA)
2. Program subsidizes flood damage insurance.
3. Required on all properties located in flood-prone area ("flood plains") if property is financed with federally related mortgage loans
Chapter 4
Agency

LECTURE OUTLINE:

I. Introduction to Real Estate Agency

A. History of the nature of real estate services and common misconceptions the public has had regarding who the broker represents

II. Law of Agency—defines the rights and duties of the principal and agent

A. Creation of agency

1. The principal delegates and the agent consents to act.
2. Express agency
   a. The parties state the terms of the agreement and express their intentions either orally or in writing.
   b. In real estate, generally written agreements rather than oral; either a listing agreement or buyer-agency agreement
3. Implied agency
   a. Implied by the actions of the parties rather than by a signed contract
   b. In real estate, the actions of the parties may create an agency relationship unintentionally, inadvertently, or accidentally where none was intended, leading to an undisclosed dual agency.
   c. Despite the disclosure of agency relationships, customers may assume that a licensee is representing them.
4. Compensation—because a person pays the compensation to the agent does not mean that person is the principal.

B. Definitions in the law of agency

1. Agent—the individual who is authorized to and consents to represent the interest of another person. In real estate the broker of the firm is the agent.
2. Subagent—the agent of an agent
3. Principal—the individual who hires and delegates to the agent the responsibility of representing his or her interests. This may be the buyer, seller, owner, or tenant.
4. Agency—the fiduciary relationship between the principal and the agent
5. Fiduciary—the relationship in which the agent is held in a position of special trust and confidence by the principal
6. Client—the principal
7. Customer—the third party for whom some level of service is provided
8. Non-agent—facilitator, transaction broker, etc.
9. Consensual agreement

C. Fiduciary duties

1. A fiduciary relationship is one of trust and confidence between employer (principal) and employee (agent).
2. Differences between client and customer services (See Table 4.1)

3. Common law of agency duties include the following as a minimum:
   a. Care: The agent must exercise reasonable degree of care; liability can result from negligence or carelessness.
   b. Obedience: The agent must act in good faith and according to the principal's instructions (as long as those instructions are legal and relative to the terms of their contract).
   c. Accounting: The broker must account for all pertinent funds and documents placed in his or her care.
   d. Loyalty: The principal's interests must come before the agent's; 100 percent loyalty is required; agent must inform the principal when purchasing the property for himself or herself or when selling his or her own property to the principal; confidentiality is a key element.
   e. Disclosure: The agent must keep the principal fully informed of all facts, including those required by the duty of discovery.
      (1) Agent for seller
          (a) All offers
          (b) Identity of prospective buyers and agent’s relationship to them
          (c) Ability of buyer to complete sale; offer a higher price
          (d) Agent’s interest, if any
          (e) Buyer’s intention to resell property for profit.
          (e) Agent’s best judgment of the fair market value of the property
      (2) Agent for buyer
          (a) Property deficiencies
          (b) Unsuitable contract provisions and financing
          (c) Suggest lowest price to offer
          (d) Length of time property on market

D. Termination of agency—for any of the following reasons

1. Death or incapacity of either party (notice of death is not necessary)
2. Destruction or condemnation of the property by eminent domain
3. Expiration of the terms of the agency
4. Mutual agreement to terminate the agency
5. Breach by one of the parties, such as abandonment by the agent or revocation by the principal (the breaching party might be liable for damages)
6. By operation of law, as in a bankruptcy of the principal (since title to the property would be transferred to a court-appointed receiver)
7. Completion or fulfillment of the purpose for which the agency was created
8. Exception: agency coupled with an interest—which means the agent has an interest in the subject of the agency (such as the property being sold)
   a. Cannot be revoked by the principal
   b. Does not automatically terminate at the principal's death

III. Types of Agency Relationships

A. Limitations on an agent’s authority

1. Universal agent—no limits on authority
   a. Created by a "general power of attorney"
b. Makes the agent an "attorney in fact"

2. General agent—one who represents the principal in a range of matters related to a particular business or activity; receives power to enter into contracts on behalf of the principal within the agent’s scope of authority.

3. Special agent—one who represents the principal in one specific transaction or one business activity only
   a. Such agency is created by the terms of the listing agreement or buyer-agency contract in the real estate business.
   b. The agent cannot enter into contracts on behalf of the principal and cannot bind the principal to any act.

4. Designated agent—one who is authorized by the broker to act as the agent of a specific principal
   a. Others in office free to act for another party in a transaction
   b. Broker may be in position of dual agent, so disclosure required
   c. Varies from state to state

B. Single agency: The broker represents either the seller or the buyer, not both in the same transaction; any third party is a customer. Precludes the sale of in-house listings to represented buyers. Broker must establish policies for firm that define client-services.

1. Seller as principal
   a. The broker becomes the agent of the seller.
   b. The relationship is established by a listing contract.
   c. The buyer becomes the customer who represents him or herself.
   d. The broker may utilize the services of other brokers who become subagents.

2. Subagency—the broker appoints other cooperating brokers who have same fiduciary responsibilities as the listing broker:
   a. Offered through MLS
   b. Created by offer of cooperation and compensation
   c. Other brokers can accept or reject subagency offer.

3. Buyer as principal
   a. The broker becomes the agent of the buyer.
   b. The relationship is established by a buyer-agency agreement.
   c. The broker becomes responsible to the buyer to locate real estate with certain specified characteristics.
   d. The seller becomes the customer.

4. Owner as principal
   a. The broker becomes the agent of the owner to manage or lease the owner’s real estate.
   b. The relationship is established by a property management agreement.

C. Dual agency: The broker represents two principals in the same transaction. (Consult state laws regarding the legal procedures for performing dual agency.)

1. Disclosed dual agency: Both principals must be informed and consent to the dual representation. Parties must understand how the dual representation could affect their respective interests when the agent is essentially trying to serve two masters.

2. Undisclosed dual agency—The actions of the parties can create an agency relationship where none was intended.
D. Disclosure of agency: Every state requires that licensees make certain disclosures.

   1. Alternatives for the level of services
   2. Who the licensee represents
   3. The advantages and consequences of representation, including subagency
   4. Mandatory or voluntary disclosures

E. Agency statutes: State legislatures are enacting agency reform legislation. Most require agents to:

   1. exercise reasonable care and skill in performing duties.
   2. obey client’s specific instructions.
   3. account for all money and property received.
   4. promote the client’s best interests (loyalty).
   5. disclose material facts.
   6. perform according to brokerage agreement terms.
   7. keep confidential all confidential information received from client.
   8. generally comply with terms of statute.

IV. Customer- Level Services

A. Duties to the third party include:

   1. reasonable care and skill in performance.
   2. honest and fair dealing.
   3. disclosure of all facts known (or that should be known) to the licensee that materially affect the value or desirability of the property
      a. Use of property disclosure forms
      b. Use of prepurchase inspections (i.e., structure, termites, environmental hazards)

B. Disclosure of environmental hazards—which include lead paint, radon, asbestos, toxic waste, contaminated soil and water, or other hazards common in the area—may be required.

C. Opinion versus fact

   1. Opinions—must be stated as licensee's opinions with no intention to deceive
   2. Facts—must be accurate
      a. Fraud—intentional misrepresentation of material fact in a way so as to harm or take advantage of an individual
      b. Puffing—exaggeration of a property's benefits; legal as long as statements are not considered fraudulent
      c. Negligent misrepresentation—broker may be ignorant about a material fact but should have known; buyer relies on broker's statement.

D. Latent defects—a hidden structural defect that would not be uncovered by ordinary inspection; seller has duty to discover any latent defects that threaten structural soundness or personal safety
E. Stigmatized properties—society has branded as undesirable because of events that occurred there, such as criminal events or other tragedies such as suicide (see state's laws and seek legal counsel for guidance about disclosure)
Definition of Real Estate Brokerage: 
A real estate broker is one who is licensed to buy, sell, exchange, or lease real property for others and charge a fee for services.
D. Legal rights and obligations

1. Brokers should seek legal counsel to protect themselves and their salespeople.
2. Real estate licensees cannot give legal advice to any party to a transaction; they should recommend that the party consult an attorney.

E. Real estate assistants and technologies

1. Assistant
   a. Combination office manager, marketer, organizer, facilitator
   b. May/may not be licensed (state law requirements)
2. Technologies
   a. Computers and related systems such as the Internet and e-mail
   b. Multi-listing and mortgage information “online” service.
   c. Portable fax, beepers, cellular phones, computers, and printers

F. Broker-salesperson relationship

1. The employing broker is directly responsible for supervising all salespersons’ real estate activities.
2. The salesperson is responsible only to his or her employing broker. All activities must be performed in the name of the employing broker.
3. Salesperson cannot receive compensation from anyone other than own broker.

G. Independent contractor versus employee status—broker controls employee; may specify what an independent contractor does but not how or require specific actions

1. IRS has three requirements to be met for independent contractor status as a "qualified real estate agent."
   a. The individual must have a current real estate license.
   b. He or she must have a written contract with the broker stating that "The salesperson will not be treated as an employee for federal tax purposes."
   c. Minimum 90 percent of the salesperson’s income must be based on sales production and not on the number of hours worked.
2. In Practice: Broker should have standardized employment agreement drafted by attorney

H. Broker’s compensation

1. Must be negotiated between the principal and the agent
2. Usually a percentage of the total amount of money involved (sales price or rent); may be a fixed dollar amount
3. The agent is entitled to a commission when he or she
   a. was licensed when the event occurred.
   b. was employed with a (written) contract by the principal.
   c. was the procuring cause of the transaction—the one who started a chain of events resulting in a sale—in many cases, even if the transaction is not consummated.
I. Salesperson's compensation

1. Must be contained in an agreement between the broker and the salesperson
2. May be fixed salary, a share of the broker's commission, a draw on future commissions, or graduated commission splits
3. May be incorporated into a 100 percent commission program
4. Math Concept: Sharing commissions

J. Transactional brokerage

1. Also referred to as non-agent, facilitator, coordinator, or contract broker.
2. Equally responsible to both parties for the paperwork and formalities of transferring ownership of real property, but may not negotiate on behalf of either; must not disclose confidential information but must disclose known defects

K. Antitrust laws

1. Price fixing: brokers must not conspire to "fix prices"—rates must be independently determined by broker for his or her firm based on the broker's business judgment and revenue requirements; must avoid even the impression that rates are standard.
2. Group boycotting: business must not conspire against other businesses or agree to withhold their patronage—known as group boycotting.
3. Allocation of customers or markets: brokers must not allocate customers or markets by dividing their markets and refraining from competing.
4. Tie-in agreements: may not “tie” the sale of first product to purchase of a second.
5. Penalties:
   a. A maximum $100,000 fine and three years in prison
   b. Corporations subjected to up to $1 million in penalties
   c. In a successful lawsuit, triple damages, plus attorney's fees and court costs

L. Fee-for-services: Internet has helped clients and customers to be more knowledgeable about real estate transactions. Licensees may unbundle services and the consumer only pays for specific services.
Chapter 6
Listing Agreements and Buyer Representation

LECTURE OUTLINE:

I. Listing Agreements
   A. Definition
      1. Listings are personal service contracts between the broker and the principal.
      2. Listing creates an employment contract.
      3. Most states require that they must be in writing to be enforceable in court.
   B. Types of listing agreements
      1. Exclusive-right-to-sell listing: One broker is appointed as the sole agent for the seller and is entitled to a commission regardless of who procures the buyer, including the seller.
      2. Exclusive-agency listing: One broker is appointed as the sole agent for the seller and is entitled to a commission regardless of who procures the buyer except the seller.
      3. Open (nonexclusive) listing: Any number of brokers as well as the seller can procure the buyer, with only the procuring broker, if any, being entitled to a commission.
   C. Special listing provisions
      1. Multiple listing service (MLS): An organization of brokers that pool listings and distributes them to its members, who then share commissions on cooperating sales
      2. In Practice: Most MLSs are now computerized.
      3. Net listing: The broker may claim all proceeds above the net amount to the seller; illegal in some states, unethical in most others.
      4. Option listing: The broker has the right to purchase the listed property.

II. Termination of Listings
   A. Termination for any of the following reasons
      1. Fulfillment of the purpose of the listing
      2. Expiration of the time period stated in the agreement
      3. Destruction of the property
      4. A change in property use by outside forces (such as a change in zoning or condemnation under eminent domain)
      5. Transfer of the title to the property by operation of law (such as a bankruptcy)
      6. Mutual consent
      7. Death or incapacity of either party
8. Breach or cancellation by one of the parties (although that party may later be liable for damages)

B. Expiration of listing period.

1. Contract must state definite termination date.
2. Automatic extension clauses are specifically prohibited by licensing authorities in some jurisdictions; the wording of some contracts also prohibits such extensions.
3. Some contracts contain a broker protection clause, which protects a broker who was procuring cause from losing commission.
Chapter 7
Interests in Real Estate

LECTURE OUTLINE:

I. Government powers ("PETE")—limitations on the ownership imposed by the government for the general welfare of community; supersede rights or interests of the individual owner

A. Police power
   1. Enabling acts grant authority from the state to local governments to protect the public health and safety and general welfare.
   2. Zoning ordinances, building codes, environmental protection laws, and other regulations (see Chapter 19 for details)

B. Eminent domain
   1. The right of the government to take privately owned real estate for public use; condemnation is the process by which this right is exercised.
   2. Legal protections for the property owner
      a. The proposed use must be declared by the courts to be a legitimate public use; used not just to create public facilities but also to protect the public from hazards.
      b. Just compensation must be paid to the owner for both the property taken and the diminished value of what is left.
      c. The rights of the owner must be protected under due process of law
   3. Right extends to quasi-government bodies; can include renewal projects.

C. Taxation—a charge on real estate to raise funds to meet the costs of government operations (see Chapter 10)

D. Escheat—provides that the ownership of real estate will revert to the state in which it is located when its former owner dies without a will (intestate) and has no heirs capable of being discovered by the state.

II. Estates in Land—defines the owner’s degree, quantity, nature, and extent of interest in real property

A. Leasehold estates—estates for fixed periods of time (see Chapter 16)
   1. Estate for years
   2. Estate from period to period (periodic estate)
   3. Estate at will
   4. Estate at sufferance

B. Freehold estates—estates for an indeterminable period of time
   1. Fee simple estate—the highest type of interest in real estate recognized by law
      a. Fee simple absolute—no limitations on fee simple ownership
b. Fee simple defeasible—qualified (limited); may be lost by the occurrence or nonoccurrence of a specified event
   (1) Fee simple subject to a condition subsequent—exists provided condition is not violated; former owner retains a right of reentry
   (2) Fee simple with special limitation—exists "so long as" limitation is met; former owner retains the possibility of a reverter, called fee simple determinable.

2. Life estate—limited to the duration of a lifetime, either that of the owner or of another designated person
   a. Conventional life estate—created by the owner by deed or will for a life tenant for the life of the life tenant or another person (pur autre vie)
      (1) Remainder interest—a future interest in the fee simple estate for the remainderman
      (2) Reversionary interest—returns to the grantor (or the grantor's heirs)
   b. Legal life estates—created by state statute rather than voluntarily by the owner
      (1) Dower—the life estate interest of a wife in the real property of her deceased husband
      (2) Curtesy—the life estate interest of a husband in the real property of his deceased wife
         (a) Community property states do not use dower or curtesy
         (b) Potential legal life estates may require both spouses to sign conveyances
      (3) Homestead rights—protect the equity in a residence from a judgment by unsecured creditors

III. Encumbrances—claim, charge, or liability that attaches to real estate

A. Two classifications
   1. Liens—monetary charge
   2. Encumbrances - physical—restrictions, easements, encroachments

B. Liens—charges against property that provide security for the debts or other obligations of the property owner (see Chapter 10)

C. Deed restrictions—private agreements that affect the use of land (see Chapter 19)

D. Easements—rights to use the land of others for particular purposes
   1. Appurtenant easement—annexed to the ownership of one parcel and used for its benefit on the land of another
      a. Servient tenement
      b. Dominant tenement
   2. Easement in gross—an individual interest in or a personal right to use the land of another (frequently for utilities)
   3. Party wall easement—used for a wall that straddles the property line of adjacent properties with different owners.
   4. Easement by necessity—arising because owners must have ingress to and egress from their land.
5. Easement by prescription—arises when use has been continuous, exclusive, and without the owner’s approval
   a. Open, notorious, visible
   b. Tacking

6. Easement by condemnation—acquired for a public purpose; requires compensation for loss in property value

7. Creating an easement
   a. By express grant in a deed from the owner of the property
   b. By express reservation by the grantor in a deed of conveyance
   c. By use
   d. By implication

8. Terminating an easement
   a. When the purpose for which it was created no longer exists
   b. By the owner of either the dominant or the servient tenement becoming the owner of both under one legal description (merger)
   c. By release of the right of easement to the owner of the servient tenement.
   d. By abandonment of the easement
   e. By the nonuse of a prescriptive easement by its owner
   f. By adverse possession by the owner of the servient tenement
   g. By destruction of the servient tenement (for instance, party wall)
   h. By court decision of a quiet title action against someone claiming an easement
   i. By excessive use (possibly a change in land use)

E. License—the privilege to use another's land for a specific purpose

F. Encroachment—anything extending from one property across the property line onto another parcel or beyond legal building lines

G. In Practice: Need to note any encroachment in the listing, make the purchase contract subject to the encroachment, and possibly advise the buyer to obtain a survey of the property

IV. Water Rights

A. Riparian rights—generally pertain to non-navigable waters
   1. Navigable – own to edge of water
   2. Non-navigable – own to center of river

B. Littoral rights—generally pertain to navigable waters
   1. Own to high water mark

C. Accretion, erosion, and avulsion
   1. Accretion—increases in land resulting from deposit of soil
   2. Erosion—loss of soil by gradually wearing away
   3. Avulsion—sudden removal of soil due to act of nature

D. Doctrine of prior appropriation—the right to use any water, except for limited domestic use, is controlled by the state.
Chapter 8
Forms of Real Estate Ownership

LECTURE OUTLINE:

I. Forms of Ownership

A. Forms
   1. Severalty
   2. Co-Ownership
   3. Trust

II. Ownership in severalty—title vested in one natural or legal person

III. Co-ownership—concurrent ownership; co-tenants

A. Tenancy in common
   1. Two or more natural or legal owners
   2. Each owner with an undivided fractional interest
   3. Unity of possession
   4. Each owner may encumber or convey his or her interest.
   5. Each interest is inheritable.

B. Joint tenancy (with rights of survivorship)
   1. Two or more natural owners only
   2. Inherent right of survivorship among the owners
   3. Creation of joint tenancy requires four unities (PITT)
      a. Possession—all joint tenants holding an undivided right to possession
      b. Interest—all joint tenants holding equal ownership interests
      c. Time—all joint tenants acquiring their interest at the same time
      d. Title—all joint tenants acquiring their interests by the same document
   4. Termination of joint tenancy occurs when any one unity is terminated.

C. Termination of co-ownership by suit for partition. The court may physically divide the property or order it sold and divide the proceeds among the disputing owners.

D. Ownership by married couples
   1. Tenancy by the entirety
      a. Special form of ownership for married couples in certain states.
      b. Husband and wife are considered one legal entity;
      c. Each has undivided interest with inherent right of survivorship
      d. Both husband and wife must sign any documents to encumber or convey the property.
      e. Termination of tenancy by entireties:
         (1) Death of either spouse; survivor becomes owner in severalty
         (2) Agreement between both parties (new deed)
         (3) Divorce (parties become tenants in common)
         (4) Court ordered sale
   2. Community property
a. Special form of ownership for married couples only
b. Husband and wife are considered equal partners, with both signatures required for conveying or mortgaging
c. Property acquired during the marriage is community property.
d. Property brought to the marriage or acquired during the marriage by gift or inheritance is separate property.
e. Does not have a right of survivorship as joint tenancy does. When one spouse dies, one-half of the property is inherited by the decedent’s heirs (which may or may not be the other spouse).

II. Trusts

A. Parties to a trust
   1. Trustor—the person who creates the trust
   2. Trustee—the party who holds legal title and must carry out the trustor’s instructions regarding the purpose of the trust; has a fiduciary responsibility
   3. Beneficiary—the person who receives the benefits of the trust

B. Living trust—created while the trustor is alive, usually by a detailed trust agreement

C. Testamentary trust—created at the grantor’s death through the grantor’s will

D. Land trust—permitted in a few states; real estate is the only asset
   1. Public records do not name beneficiary
   2. Property can be pledged as security without having mortgage recorded; beneficial interest is personal property
   3. Continues for a definite term; if not extended, expires

III. Ownership of Real Estate by Business Organizations

A. Partnerships—two or more people who carry on a business for profit as co-owners
   1. General partnership: All partners are general partners who participate in the partnership; share full liability.
   2. Limited partnership: The general partner provides the management for the limited (nonparticipating) partners; limited partners are only liable to the extent of their investment.
   3. Most states have adopted the Uniform Partnership Act (UPA).

B. Corporations
   1. A legal entity (“artificial person”); chartered under state law
   2. Exist in perpetuity until formally dissolved
   3. Managed and operated by board of directors
   4. Provide its shareholders with limited liability
   5. Corporate profits are usually subject to double taxation unless a Chapter S corporation.

C. Syndicates and joint ventures
1. Syndicate—a joining together of two or more people or firms to make and operate a real estate investment; can take one of the several forms of ownership previously mentioned
2. Joint venture—form of ownership in which two or more people or firms carry out a single business project

D. Limited liability companies (LLC)

1. Combines features of limited partnerships and corporations
2. Members have the limited liability of a corporation plus the tax advantages of a partnership.

IV. Condominiums, Cooperatives, and Time-Shares

A. Condominiums

1. Created under horizontal property laws or uniform condominium act laws—declaration of condominium
2. The purchaser is a fee simple owner who receives a deed to
   a. individual ownership of an individual unit and
   b. tenant-in-common interest for the common elements.
3. Can be for any type of real estate, not just residential
4. There is no right to partition condominium ownership.
5. Most states have adopted Uniform Condominium Act, which requires a Declaration of Condominium be recorded.
6. Require periodic fees for common area expenses and assessments for special expenses
7. Individual ownership unit is assessed for real property tax.
8. Title can be liened like any other real estate ownership.
9. Administered by association of unit owners

B. Cooperative ownership

1. Title is held by a corporation.
2. The purchaser is a shareholder who receives
   a. a stock certificate and
   b. a proprietary lease.
3. Operated and managed by board of shareholders.
4. Shareholders pay fees to support the corporation’s expenses; liability for nonpayment of fees by other shareholders to support the cooperative
5. Method of transfer of ownership important issue. May require approval by board of directors and selling of stock back to corporation.

C. Time-share ownership

1. Can be either a time-share estate (fee simple interest) or a time-share use, (right to use only; developer owns the real estate)
2. The purchaser usually receives the right to occupy a certain unit for a specified time-frame each year (one week being the most common).
3. State laws that govern time-shares are extremely complex and varied, requiring specialized competent legal counsel.
4. In Practice: Time-shares are frequently regulated as subdivisions and sales may be subject to federal securities laws.
Chapter 9
Legal Descriptions

LECTURE OUTLINE:

I. Describing land: The legal description of a parcel of property is the exact location of the parcel according to an established system; the description is legally sufficient if a competent surveyor can locate the parcel using that description.

II. Methods of describing real estate

A. Metes-and-bounds legal descriptions

1. Must have a specific point of beginning (POB)
2. Must have measurements (metes = distances)
3. Must have linear boundaries (bounds = directions)
4. Must completely enclose the area (return to the POB)
5. Monuments are used to mark the ends of the measurements/corners of the survey.

B. Rectangular (government) survey system

1. Established by Congress in 1785
2. Based on two intersecting lines
   a. Principal meridians that run North and South
   b. Base lines that run East and West
      (1) Both principal meridians and base lines are located in reference to degrees of longitude and latitude.
      (2) Each principal meridian is named and is crossed by its own base line.
      (3) The rectangular survey system affects specific land areas within the boundaries.
3. Township tiers
   a. Township lines are six miles apart and run East and West parallel to the base line.
   b. Township strips (tiers) are six-mile wide strips of townships that are numbered North and South of the base line.
4. Range
   a. Range lines are six miles apart and run North and South parallel to the principal meridian.
   b. Range strips (ranges) are six-mile wide strips of townships that are numbered East and West of the principal meridian.
5. Township squares
   a. Townships are formed by intersecting pairs of township lines and range lines (the intersection of a township strip and a range strip).
   b. Each township is six miles square and contains 36 square miles (36 sections) or 23,040 acres.
6. Sections
   a. There are 36 sections in a township.
b. They are numbered 1 through 36, starting in the top right corner and moving East to West and then West to East (similar to the way a field is plowed).

c. Each section is one mile square and contains one square mile or 640 acres.

d. Section 16 is dedicated as the school section.

e. They are divided into quarters for reference purposes.

f. Correction lines

1. Correction lines are required to overcome the effect of the earth’s curvature on range lines.

2. Every fourth township line is a correction line.

3. Guide meridians run North and South at 24-mile intervals from the principal meridian.

4. Adjustments are made on the North and West boundaries of a township (sections 1 through 7, 18, 19, 30, 31).

g. Fractional sections and government lots

1. Undersized or oversized sections are classified as fractional lots.

2. Areas smaller than full quarter-sections are designated as Government lots.

3. They are used to correct survey errors and physical disparities (such as a partially-submerged property).

h. Reading a government survey legal description and calculating the size of a tract of land

1. Start at the end of description and work backward to the beginning.

2. Begin size calculations from right hand side with section containing 640 acres, then divide by each fraction given as you move to the left (the beginning of description) of the principal meridian.

i. Metes-and-bounds descriptions within the rectangular survey system.

Used when:

1. tract is irregular or too small to be described by quarter sections.

2. tract does not follow the lot or block lines of recorded subdivision.

3. tract does not follow the section, quarter-section, or fractional section lines.

C. Lot-and-block (recorded plat) system

1. This system uses a recorded subdivision plat map.

2. It requires a survey plat by a licensed surveyor or land engineer.

3. Identified properties may later be resubdivided.

IV. Measuring Elevations

A. Condominium laws require a legal definition of the horizontal property rights included with each unit (air lots).

B. Subsurface rights are also defined using datum.

C. Datum—a point of reference for measuring elevations

1. The United States Geological Survey (USGS) uses mean (average) sea level in New York Harbor.

2. Many large cities use official local datum rather than USGS datum.
3. Benchmarks—permanent reference points used primarily to mark elevations; monuments are traditionally used to mark only surface measurements

V. Land Units and Measurements

VI. Math Concept: Land acquisition costs

1. Area times cost per square foot (or per acre)
2. Use the same unit in which cost is given
Chapter 10
Real Estate Taxes and Other Liens

LECTURE OUTLINE:

I. Lien—a charge against property that provides security for a debt of the property owner
   A. Encumbrance—any charge or claim that burdens the title to real property, including liens and nonmonetary claims
   B. Liens may be voluntary or involuntary, statutory or equitable, and general or specific.
   C. General liens—affect all property owned by a debtor, both real and personal
      1. Judgment liens
      2. Estate and inheritance tax liens
      3. Debts of a deceased person (decedent)
      4. Corporation franchise tax liens
      5. Internal Revenue Service (income) tax liens
      6. A lien attaches to real property the moment it is filed.
      7. A lien does not attach to personal property until that property is seized.
   D. Specific liens—affect only one identified parcel of real property
      1. Real estate tax (ad valorem tax) liens
      2. Special assessment liens
      3. Mortgage liens
      4. Trust deed liens
      5. Mechanic's liens
      6. Utility liens (refer to local laws)
      7. Bail bond liens
   E. The effect of liens on title
      1. Liens run with the land.
      2. Liens attach to the property, not the property owner.
   F. Priority of liens
      1. The order in which claims against the property will be satisfied.
      2. Generally, real estate taxes and special assessments take priority over all other liens.
      3. Other liens follow in the order that they were recorded.
      4. Some exceptions exist, particularly for mechanic's liens.
      5. Subordination agreements between lien holders can change priority.
II. Real Estate Tax Liens

A. General ad valorem tax

1. They are levied by taxing bodies as a government power.
   a. States and counties
   b. Cities, towns, and villages
   c. School districts
   d. Drainage districts
   e. Water districts
   f. Sanitary districts
   g. Parks, forest preserve, and recreation districts
2. They are levied according to the value of the property being taxed (ad valorem = according to value).
3. Ad valorem are *specific, involuntary, statutory* liens.
4. Exemptions: properties used for tax-exempt purposes:
   a. Cities
   b. Various municipal organizations
   c. State and local governments
   d. Hospitals
   e. Educational institutions
5. The method of assessment varies among jurisdiction (for example, a property's market value, a percentage of market value or replacement cost).
6. Equalization process used to achieve uniformity
7. Arriving at the tax rates
   a. A budget must be adopted by the taxing body.
   b. The amount of tax money needed specifically from real estate is derived from the budget figures.
   c. An appropriation is made, authorizing the expenditure of such funds and providing for their sources.
   d. The tax levy is imposed on each parcel of real property.
   e. The tax rate us computed for each property.
   f. The tax bill is sent to each property owner.
8. Tax bills
   a. Usually one tax bill incorporates all taxes levied by various taxing bodies.
   b. For tax bodies operating on different budget years, separate tax bills are sent.
   c. Due date, called penalty date, is set by statute.
   d. Discounts are offered to encourage prompt payment.
9. Enforcement of tax liens
   a. The taxes must be valid to be enforceable.
   b. The provisions for delinquent taxes include
      (1) published notice after a court has rendered a judgment
      (2) tax sale
      (3) penalties imposed when the delinquent taxes are paid
      (4) the rights of redemption
         (a) equitable right of redemption
         (b) statutory right of redemption

B. Special assessments (improvement taxes)

1. Always *specific and statutory* liens
a. Voluntary—the property owners in the area to be affected can petition for the improvement.
b. Involuntary—the appropriate governmental authority can initiate the procedure.

2. Costs are spread over the assessment roll properties
   a. on a fractional basis (equal costs) or
   b. on a front-footage basis (prorated costs).

3. The annual bills are typically spread out for a number of years, with the property owner having the right to prepay at any time without penalty.

III. Other Liens on Real Property

A. Mortgage liens and deed of trust liens—voluntary, specific liens used in real estate financing (see Chapters 14 and 15)

B. Mechanic's liens—involuntary, statutory, specific liens
   1. Mechanic's liens give security to those who perform labor or furnish material in the improvement of real property.
   2. There must be a contract (expressed or implied, but usually written) between the owner and the contractor.
   3. Depending on the jurisdiction, lien priority can be established by
      a. the date the construction began or materials were first furnished,
      b. the date the work was completed,
      c. the date the individual subcontractor's work was either commenced or completed,
      d. the date the contract was signed or work was ordered, or
      e. the date a notice of the lien was recorded, filed, posted, or served.
   4. In some states it may be given priority over previously recorded liens.

C. Judgment liens—involuntary, equitable, general liens
   1. A judgment is a decree issued by a court at the end of a lawsuit.
   2. A judgment lien takes its lien priority according to the laws of the state in which the property (real or personal) is located.
   3. It is enforced through the issuance of a writ of execution and the ultimate sale of the property.
   4. When property is sold, a satisfaction of judgment should be filed.
   5. Lis pendens (litigation pending) is an encumbrance that is a notice of a possible future lien on real estate.
   6. Attachments—the court retains custody of property until a lawsuit is concluded.

D. Estate and inheritance tax liens—involuntary, statutory, general liens (see Chapter 12); they are usually paid during the probate court proceedings.

E. Utility liens—involuntary, equitable, specific liens granted to municipalities to assure collection of the funds due them for utility services they have provided

F. Bail bond liens—voluntary, statutory, specific liens to assure the appearance of the defendant in a criminal action
G. Corporate franchise tax liens—*involuntary, statutory, general* liens for taxes imposed on corporations as a condition of their conducting business in some states

H. Internal Revenue Service (income) tax liens—*involuntary, statutory, general* liens that result from a person's failure to pay any portion of his or her federal tax liability, such as income and withholding taxes
Chapter 11
Real Estate Contracts

LECTURE OUTLINE:

I. Contract Law

A. Contract: a voluntary agreement or promise between legally competent parties, supported by legal consideration, to perform (or refrain from performing) some legal act

1. Contracts may be express(ed) in writing or orally.
2. Contracts may be implied by action or conduct.
3. In bilateral contracts, all parties promise to do something for one another; they bind all parties and are enforceable against all parties.
4. In unilateral contracts, one party promises to do something to induce the second party to do something; they are binding on and enforceable against only one party.
5. Executed contracts are those that have been fully performed.
6. Executory contracts require some performance by one or more parties before they are completed.

B. Essential elements of a valid contract

1. Offer and acceptance—mutual assent or meeting of the minds
   a. Offer—promise made by one party (offeror) with the request for something in exchange for that promise—may be terminated by
      (1) Rejection, including a counteroffer
      (2) Failure to accept within prescribed time period
      (3) Revocation by the offeror before acceptance
   b. Acceptance—promise by the offeree to be bound by the exact terms proposed by the offeror
   c. Counteroffer—a new offer which rejects the original offer
2. Consideration—something of legal value; that which is "good or valuable" between the parties. Courts do not inquire into the adequacy of consideration.
3. Legal object
4. Written and signed agreement (unless allowed by the statute of frauds)
5. Accurate description of the real estate
6. Legally competent parties
   a. Of legal age
   b. Sufficient mental capacity to understand the actions or consequences

C. Validity of Contracts

6. Contracts can be:
   a. Valid—complies with the essentials of a valid contract
   b. Void—has no legal effect (in theory, never was a contract); lacks essential elements of a valid contract
   c. Voidable—may be disaffirmed or voided by one party based on some legal principle
d. Unenforceable—no party may sue for performance; type of contract being used.

3. Reality of consent—parties must be able to make a prudent and knowledgeable decision without undue influence. May be deprived by:
   a. Mistake
   b. Misrepresentation
   c. Fraud
   d. Undue influence, including chemical substances
   e. Duress

C. Discharge of contracts; discharged when terminated, completely performed, a party’s breach or default

1. Performance of contract
   a. "Time is of the essence" means the contract must be performed within the stipulated time.
   b. If no time is stipulated, it should be performed within a reasonable time.

2. Assignment—the transfer of rights and obligations under a contract to a third party (assignee)

3. Novation—the substitution of a new contract for an existing contract

4. Breach of contract
   a. If the seller defaults, the buyer may
      (1) rescind the contract and recover the earnest money.
      (2) sue the seller for specific performance.
      (3) sue the seller for compensatory damages.
   b. If the buyer defaults, the seller may
      (1) declare the contract forfeited and retain the earnest money.
      (2) rescind the contract but return the earnest money.
      (3) sue the buyer for the purchase price.
      (4) sue the buyer for compensatory damages.

5. Statute of limitations—the time limit in which to enforce rights; time varies for different legal actions, rights not enforced within time period are lost

6. Contracts may be discharged or terminated when any of the following occur:
   a. Partial performance—with written acceptance
   b. Substantial performance—may be sufficient to force payment with certain adjustments
   c. Impossibility of performance—legally impossible to perform the required act
   d. Mutual agreement—by the parties to cancel the contract
   e. Operation of law—as in the voiding of a contract by a minor, result of fraud, improper alteration of the contract, or expiration of statute of limitations
   f. Rescission—one party may rescind the contract and return the parties to their original positions; monies that have been exchanged must be returned

II. Contracts Used in the Real Estate Business

A. Written agreements most commonly used:

1. Listing agreements and buyer agency agreements
2. Real estate sales contracts
3. Option agreements
4. Contracts for deed (land contracts)
5. Leases and escrow agreements

B. Contract forms

1. Each state has different requirements regarding this matter.
2. A real estate licensee who is not a licensed attorney may not practice law, i.e., draw up a contract.
3. Preprinted forms are commonly used but raise three problems.
   a. What information is to be used in filling in the blanks
   b. What preprinted information needs to be deleted
   c. What additional information is to be added using addenda
4. In Practice: Students should become familiar with various types of contracts used in the area; parties should have their attorneys review contracts to ensure understanding.

C. Listing agreements and buyer agency (see Chapter 6)

1. Listing agreement is an employment contract; establishes the relationship between the broker and principal.
2. Some states require or suggest the use of specific forms.
3. Some jurisdictions require listings to be in writing to be enforceable; others recognize the validity of oral listings.
4. In Practice: If there is an ambiguity in the listing, it will usually be interpreted against the broker who prepared the contract.

D. Sales contracts (refer to the name used in your area) (Agreement of Sale, Offer to Purchase, Contract of Purchase and Sale, Purchase Agreement, Earnest Money Agreement)

1. An offer can become or "ripen into" a sales contract.
2. The sales contract is the most important document in a transaction because it establishes the legal rights and obligations of the buyer and seller; it dictates the contents of a deed.
3. Offer
4. Counteroffer
   a. Original offer ceases to exist.
   b. Buyer may accept or reject counteroffer
   c. Counteroffer may be revoked at any time before it has been accepted.
5. Acceptance—there must be an acceptance to create a contract.
   a. If accepted as written, the contract is created and a signed copy must be given to all parties.
   b. Notification of acceptance must be given to the party who made the offer before the contract is considered created.
6. Binder—used in some areas as a "short form" sales contract
7. Earnest money deposits—evidence of the buyer’s intention to carry out the terms of the contract
   a. Should be held by the broker, escrow agent or attorney in a trust or escrow account
b. Amount to be agreed upon by buyer and seller
c. Should show how interest earned will be distributed
d. Should be of a sufficient amount to discourage the buyer from defaulting and compensate the seller for taking the property off the market

8. Equitable title: After the contract is created but before the deed is delivered, the buyer may have an insurable interest in the property being purchased. (Contrast legal title to equitable title)

9. Destruction of premises: Depending on the jurisdiction, either the seller or the buyer can be responsible for the property after the contract is created but before the deed is delivered.

10. Liquidated damages: Commonly, the contract specifies that the earnest money will be used as liquidated damages, which is an amount agreed to by the parties to compensate one if the other breaches the contract.

11. Parts of a sales contract
   a. The identification of the buyer and the statement of the buyer’s obligations
   b. The legal description of the property (adequate description such as street address)
   c. The identification of the seller and the statement of the type of deed the seller will give, including any covenants, conditions, and restrictions that bind the property
   d. The statement of the purchase price and the complete financial arrangements for its payment
   e. Amount and form of down payment
   f. The provisions for closing and the transfer of possession to the buyer
   g. The provisions for title evidence
   h. The provisions for prorations
   i. The provisions regarding the damage to or destruction of the premises
   j. The provisions for remedies in the event of a breach of the contract
   k. The provisions for any contingencies in the contract
   l. Date and signatures of parties (refer to state’s procedures for signatures of non-owning spouses)
   m. Agency disclosure statement
   n. Additional provisions
      (1) The identification of any personal property to be left with the premises for the buyer
      (2) The identification of any real property to be removed by the seller prior to the closing
      (3) The transfer of any applicable warranties
      (4) The identification of any leased equipment to be transferred to the buyer or returned to the lessor
      (5) The appointment of a closing or settlement agent
      (6) The closing or settlement instructions
      (7) The transfer of any impound or escrow account funds
      (8) The transfer or payment of any outstanding special assessments
      (9) The provisions for the walk-through inspection
      (10) The agreement regarding the documents to be provided by each party.
   o. Contingencies—additional conditions that must be satisfied before a sales contract is fully enforceable (include examples of those commonly used in your area)
      (1) Elements are:
         (a) Actions necessary to satisfy
(b) Time frame within which to perform
(c) Any costs involved, who is responsible for payment
(2) Taxes, mortgage, inspections, property sale, escape clauses
p. Amendments and addenda
   (1) Amendment is a change to existing content of a contract.
   (2) Addendum is an additional, new provision to a contract.
q. Disclosures—property conditions or agency representation, either by custom or required by state law (see Chapter 4)

E. Option agreements

1. Grant the right to buy or lease property at a fixed price within a stated period of time
2. The optionee gives valuable consideration and has the right to
   a. Buy or lease the property
   b. Let the option expire
3. The optionor must
   a. Reserve the property for only the optionee
   b. Sell or lease the property if the optionee exercises the option

F. Land contracts (refer to the name used in your area) (Contract for Deed, Bond for Title, Installment Contract)

1. The seller/vendor retains fee simple ownership of the property.
2. The buyer/vendee receives possession and equitable title; becomes responsible for paying principal, interest, real estate taxes, hazard insurance premiums, and maintenance and repairs on the property depending on terms of the contract.
3. The seller delivers the deed when the terms of the contract have been met, usually full payment of the contract amount.
4. In Practice: An attorney should be consulted if a land contract is to be used.
Chapter 12
Transfer of Title

LECTURE OUTLINE:

I. Title—the right to and evidence of the ownership

II. Voluntary Alienation—the owner intentionally conveys the ownership during his or her lifetime using some form of deed; may be a gift or a sale.

A. Requirements for a valid deed

1. A grantor who has legal capacity to sign the deed; a deed signed by minors or individuals declared legally incompetent could be either void or voidable.

2. A grantee named so that he or she can be readily identified; stage names and fictitious names are permitted, but no conveyances are allowed using "or"

3. A recital of consideration (consult state's laws for any specific requirements)

4. A granting clause—the words of conveyance

5. A habendum clause—the "to have and to hold" clause that defines the ownership taken by the grantee

6. An accurate legal description of the property being conveyed

7. Any exceptions or reservations to the title (for example, easements, deed restrictions or restrictive covenants)

8. The signature of the grantor, sometimes with a seal or before a notary public or other officer of the court

9. Acknowledgment—that the signature is genuine and a free and voluntary act (consult state's laws for requirements); usually required for recordation

10. The delivery of the deed to and its acceptance by the grantee

B. Execution of corporate deeds; varies from state to state

1. The conveyance of corporate-owned real estate requires a proper resolution by its board of directors or some other authority from its bylaws.

2. The deed must be signed by an authorized corporate officer.

C. Types of deeds

1. General warranty deed
   a. May contain express written warranties; may state "convey and warrant" or "warrant generally" depending on state law
   b. May contain implied warranties according to state statutes
   c. The basic warranties are
      (1) The covenant of seisin: The owner has full ownership and the legal right to convey the title.
      (2) The covenant against encumbrances: The title is free from all liens and encumbrances except those specifically stated.
      (3) The covenant of quiet enjoyment: The grantor assumes responsibility for protecting the title against the claims of third parties.
The covenant of further assurance: The grantor will furnish whatever is needed to make the title good.

The covenant of warranty forever: The grantor is liable for reimbursing the grantee for any title interest lost in the future.

d. Grantor defends title against both himself and against all those who previously held title.

2. Special warranty deed
a. Contains clause "remise, release, alienate, and convey"

b. Warrants only that the title was not encumbered while the grantor held it except as noted in the deed.

c. Any additional warranties must be specifically stated in the deed

d. May be used by a fiduciary

3. Bargain and sale deed
a. May state "grant and release" or "grant, bargain, and sell" in the document, depending on state law

b. Contains no warranties against encumbrances unless stated

c. Only implies that the grantor holds title and possession

4. Quitclaim deed
a. Provides the least protection to the grantee

b. Carries no covenants or warranties whatsoever

c. Transfers only what interest the grantor may have, if any.

d. May state "remises, releases, and quitclaims"

e. May be used to transfer a right or interest in real estate, such as an easement

f. Often used to cure a defect in title

5. Deed of trust
a. Used by a trustor to convey property to a trustee for the benefit of a beneficiary

b. Usually accompanied by a trust agreement regulating the trustee's actions

c. Usually written as a special warranty deed

6. Trustee's deed
a. Used to convey property out of a trust to anyone other than the trustor

b. Executed by the authority granted to the trustee

7. Reconveyance deed—executed by the trustee to return (reconvey) title property held in trust to the trustor

8. A deed executed pursuant to a court order
a. Usually a statutory deed form used to convey title

b. Includes executor's deeds, administrator's deeds, sheriff's deeds, and others

c. Used to convey title to property transferred by court order or by will

d. The full consideration paid is usually stated on the deed.

D. Transfer tax stamps

1. Usually payable when the deed is recorded; also called documentary stamps.

2. Paid by the seller, buyer, or split, depending on local custom or law

3. Collected by some states and counties

4. Rates vary from one jurisdiction to another.

5. Some jurisdictions use a transfer declaration form, transfer statement, or affidavit of real property value as basis for calculating tax.

6. Some deeds are exempted from the tax, such as:
a. gifts.
b. deeds not made in connection with a sale.
c. conveyances to or between governmental bodies.
d. deeds by charitable, religious or educational organizations.
e. deeds securing debts or releasing property as security for a debt.
f. partitions.
g. tax deeds.
h. deeds pursuant to mergers of corporations.
i. deeds from subsidiary to parent corporations for cancellation of stock.

7. Math Concept: Calculation of transfer taxes

III. Involuntary Alienation—transfers without the owner's consent

A. Transfer by operation of law

1. Eminent domain (through condemnation)
2. Escheat
3. Any type of foreclosure; for example delinquent real estate taxes or special assessments, mortgage or deed of trust laws, mechanic's liens, judgment liens.

B. Transfer by natural forces (see Chapter 7)

1. Accretion—the slow accumulation of soil, rock, or other matter deposited on one's property by the movement of water
2. Erosion—the gradual wearing away of the land
3. Avulsion—the sudden and violent tearing away of the land
4. Other acts of nature such as earthquakes, hurricanes, etc.
5. Alluvion— the deposit of soil, rock, or other matter on one's property
6. Accession

C. Transfer by adverse possession

1. Possession by the trespasser must be open, notorious, continuous for a statutory number of years, hostile, and adverse to the true owner.
2. Tacking permits combining successive periods of adverse possession by different persons.
3. Each jurisdiction has its own minimum requirements before an adverse possession claim can be filed.

IV. Transfer of a Deceased Person's Property

A. Transfer of title by will—a devise; the person dies testate

1. A will is a testamentary instrument that becomes effective only after the death of its maker.
2. It must strictly adhere to the laws of the state.
3. It cannot supersede dower and curtesy laws (where they apply)
4. The requirements for a valid will are
   a. The maker (the testator) must be of legal age.
   b. The testator must be of sound mind.
   c. The will must contain proper wording according to state law.
   d. It must be a free and voluntary act; the maker must be under no undue influence.
e. The signing of the will must be witnessed by two or more persons in most states
5. A codicil is a modification of or an amendment to a will.
6. A holographic will is in its maker's own handwriting.
7. A nuncupative will is given verbally by its maker.
8. Some states do not permit property to be conveyed by oral or handwritten wills.
9. Bequest
B. Transfer of title by descent—the laws of the state determine to whom ownership passes; the person dies intestate

1. The laws of intestate succession vary from state to state.
2. Generally, there are primary heirs (spouse, children).
3. The closeness of one's relationship to the deceased determines the amount of the estate that will be received.

C. Probate proceedings—the purpose is to see that assets are distributed properly; affects only those assets that do not otherwise distribute themselves by their title.

1. It is a legal process that
   a. proves or confirms the validity of the will.
   b. determines the precise assets of the deceased person.
   c. identifies the persons to whom the assets are to pass.
   d. takes place in the county where the decedent resided.
2. An administrator/administratrix is appointed if there is no will designating an executor/executrix. ix = female.
3. Legal procedures vary considerably from state to state.
4. The decedent's debts must be satisfied before any property can be disbursed to the devisees or heirs.
5. In Practice: Commissions on properties listed through probate are fixed by the court and paid only after the sale has been approved by the court.
Chapter 13
Title Records

LECTURE OUTLINE:

I. Public records—give the public legal and constructive notice of written documents that affect the real estate

A. Records maintained by:
   1. Recorder of deeds
   2. County clerks
   3. County treasurers
   4. City clerks
   5. Collectors
   6. Clerks of courts

B. Recording
   1. Placing documents in public record
   2. Recording acts
      a. Documents must be recorded in the county where the real estate is located.
      b. Documents must be drawn and recorded according to the provisions of the recording statutes of that jurisdiction.
   3. Recording usually reveals the condition of title.
   4. Purchasers can rely on public records.

C. Notice
   1. Constructive notice
      a. The legal presumption that information is available and by diligent inquiry an individual can obtain it
      b. Includes properly recording documents and the physical possession of the property
   2. Actual notice
      a. Direct or actual knowledge
      b. Includes knowing what has been recorded and personal inspection of the property
   3. Inquiry notice—notice that the law presumes a reasonable person would obtain by making further inquiry into a property.

D. Priority
   1. Generally established by the date and time of recording
   2. Can be very complex and require legal advice

E. Unrecorded documents
   1. Direct liens, such as real estate tax liens and special assessment liens
2. Statutory liens, such as estate tax liens, inheritance tax liens, bail bond liens and corporate franchise tax liens

F. Chain of title
   1. Recorded history of all of the matters that affect the title
   2. Include ownership, encumbrances, and liens
   3. Beginning with the original source of ownership and linking the passage of ownership to subsequent owners to form a chain
   4. A gap in the chain requires a suit to quiet title or quitclaim deeds to establish ownership.

G. Title search and abstract of title
   1. An examination of public records to determine what defects, if any, exist in the chain of title
   2. Search begins with present owner and traces back to the origin of title.
   3. Length of search depends on local custom or laws.
      a. 40-60 years
      b. Marketable Title Act—extinguishes certain interests and cures certain defects arising prior to the "root of the title;" necessitates a search only to the root.
   4. Abstract of title
      a. Summary report of the items about a property that can be found in public record
      b. Prepared by an abstractor
      c. Does not reveal items that cannot be found in the public records

H. Marketable title
   1. Discloses no serious defects and does not depend on doubtful questions of law or fact to prove its validity
   2. Does not expose a purchaser to the hazard of litigation or threaten the quiet enjoyment of the property
   3. Convinces a reasonably well-informed and prudent person that he or she could, in turn, sell or mortgage the property
   4. Unmarketable title can still be transferred but its defects may limit or restrict its ownership.
   5. Typical sales contract requires the seller to deliver marketable title to the buyer.
   6. Customary for a preliminary title search to be conducted after sales contract is signed to give the buyer opportunity to review and seller time to cure defects before settlement.

II. Proof of Ownership—evidence of title; deed by itself not sufficient

A. Certificate of title
   1. Statement of opinion of the title's status as of the date of the certificate
   2. Based on the title search
   3. Prepared by a title company, licensed abstracter, or an attorney
   4. Imperfect because unrecorded liens, rights of parties in possession, and hidden defects such as forged deeds, marital interests, or fraud cannot be detected.
B. Abstract and attorney's opinion

1. May be used in some areas as sufficient evidence
2. Attorney's opinion issued on basis of abstract
3. Imperfect because of the same conditions that affect a certificate of title

C. Title insurance

1. Insures the policyholder against loss due to defects in the title other than those exceptions identified in the policy
2. Based on the title search
3. Preliminary report of title (commitment to issue policy) issued describing policy to be issued and includes
   a. Name of insured party
   b. Legal description of property
   c. Estate or interest covered
   d. Conditions and stipulations
   e. Schedule of exceptions
4. Premium paid once, at closing
5. The insurer's liability cannot exceed the face amount of the policy unless an inflation rider is included.
6. The maximum loss a company liable for cannot exceed face amount of policy.
7. When title company makes payment to settle a claim, it acquires rights to any remedy or damages available to insured (called subrogation).
8. Extent of coverage
   a. Standard coverage policy—insures against
      (1) Defects found in public records
      (2) Forged documents
      (3) Incompetent grantors
      (4) Incorrect marital statements
      (5) Improperly delivered deeds
   b. Extended coverage policy—insures against
      (1) All perils insured against by the standard coverage policy
      (2) Property inspection, including unrecorded rights of persons in possession
      (3) Examination of survey
      (4) Unrecorded liens not known of by the policyholder
   c. Typical exclusions
      (1) Defects and liens listed in the policy
      (2) Defects known to the buyer
      (3) Changes in land use brought about by changes in zoning ordinances
9. Different types of policies depending on who is insured
   a. Owner's policy—issued for the benefit of the owner
   b. Lender's policy—issued for the benefit of the mortgagee; coverage commensurate with amount of loan; does not protect owner's interest
   c. Leasehold and certificate of sale policies

D. The Torrens System
1. Written application to register the title is made with the clerk of the county court where the property is located.
2. A court hearing is held, and the court enters an order to register the real estate with the registrar of titles.
3. Such registration reveals the owner and some, but not necessarily all, outstanding liens.
4. Torrens registration is the title.

III. Uniform Commercial Code (UCC)

A. Adopted at least in part in all states

B. Relates to when personal property is the collateral for a loan

C. Requires and prescribes the use of the following types of forms:

1. Security agreement—contains a complete description of the items against which the lien applies
2. Financing statement (UCC-1)—the short form of the security agreement which must be recorded
Chapter 14
Real Estate Financing: Principles

LECTURE OUTLINE:

I. Mortgage Law

A. A mortgage is a voluntary lien on real estate, given by the mortgagor to secure the payment of a debt or the performance of an obligation to the mortgagee.

1. Mortgagor = borrower; mortgagee = lender
2. Title theory states—the mortgagor gives the mortgagee legal title and retains equitable title. Legal title is returned to the mortgagor upon full payment of the debt.
3. Lien theory states—the mortgagor retains legal and equitable title. The mortgagee has only a lien on the property as security for the debt. The lender must initiate foreclosure proceedings to obtain legal title.
4. Intermediate theory states—based on title theory but requires the lender to foreclose to obtain legal title. Distinctions must be made under the specific state’s laws.

II. Security and Debt

A. Any interest in real estate that may be sold may also be used as security (collateral) for a debt.

B. Mortgage loan instruments

1. Two documents must be signed.
   a. The promissory note (financing document), the written promise to repay the debt
   b. The mortgage (security document), the document that creates the lien or transfers an interest to the creditor
2. Hypothecation—pledging property as collateral without giving up its possession
3. Deed of trust
   a. Similar to, but not identical to, a mortgage
   b. Creates a three-party agreement
   c. Conveys "naked title" or "bare legal title" to the third party (the trustee) who has certain obligations to the lender (the beneficiary); the borrower is the trustor.
   d. Generally provides simpler and faster foreclosure than a mortgage
   e. Can be used to secure multiple promissory notes

III. Provisions of the Note

A. The promissory note

1. Will contain the amount of the debt, the time and method of payment, and the rate of interest
2. If used with a mortgage, will be payable to the lender
3. If used with a deed of trust, can be payable "to bearer"
4. Can refer to or repeat several of the clauses contained in the mortgage or the deed of trust
5. Is a negotiable instrument; holder of note—payee; may transfer rights to the future payments
   a. By signing the instrument over to third party
   b. By delivering the instrument to the third party

B. Interest
   1. A charge for the use of money
   2. May be due at the end of each payment period—interest in arrears (the normal method of interest payment)
   3. May be due at the beginning of each payment period—interest in advance

C. Usury
   1. Charging interest in excess of maximum rate that may be legally charged
   2. Maximum rate generally set by state law
   3. Some states set fixed amount, others have floating interest rate.

D. Loan origination fees—expense that is paid to the lender for generating the loan

E. Discount points
   1. Used to increase the yield (true rate of interest) required by an investor who would purchase a loan
   2. Number of points determined by
      a. difference between the interest rate and required yield
      b. length of time lender expects borrower to pay off loan
   3. One discount point equals 1 percent of the loan amount.
   4. Math Concept: Discount points and investor yields

F. Prepayment
   1. Borrower may pay off loan in full at any time before the end of the term of the loan or make additional payments to principal during the term.
   2. Penalties may be assessed by the lender to compensate for unearned interest when a loan is paid in full prior to the scheduled end of the loan term.
      a. Prepayment penalties may be regulated by state law.
      b. Prepayment penalties are prohibited on mortgage loans insured or guaranteed by the federal government or sold to Fannie Mae or Freddie Mac.

IV. Provisions of the Mortgage Document or Deed of Trust
   A. Refers to the terms of the note and clearly establishes that the property is security for the debt
   B. Duties of the mortgagor or trustor
1. Payment of the debt in accordance with the terms of the note
2. Payment of real estate taxes
3. Maintenance of adequate insurance to protect the lender's interest in the property
4. Maintenance of the property to keep it in good repair
5. Lender authorization before making major alterations

C. Provisions for default

1. The lender may accelerate the maturity of the debt in case of default—acceleration clause.
2. The lender can step in to pay the real estate taxes or insurance, or physically repair or maintain the property.

D. Assignment of the mortgage

1. The note can be sold to a third-party investor.
2. The securing mortgage or deed of trust will be assigned with the note to its purchaser.
3. When debt paid in full (satisfied), assignee is required to execute the satisfaction (release) of the security instrument.

E. Release of the mortgage lien or deed of trust

1. Mortgage, The defeasance clause requires the execution of a satisfaction of mortgage (release of mortgage or mortgage discharge) when the note has been paid.
2. Deed of trust requires the execution of a release deed or deed of reconveyance.

F. Tax and insurance reserves

1. Required for some mortgages by the lender; called reserve fund, impound, or trust or escrow account.
2. Accounts set up for real estate taxes and insurance premium.
3. RESPA limits the amount that can be held as reserves.
4. Flood insurance reserves
   b. Lender must notify borrower if property is in flood hazard area.
   c. If borrower fails to purchase flood insurance, lender must buy on borrower's behalf; may charge back to borrower.

G. Assignment of rents

1. May be in the mortgage or deed of trust or in a separate document
2. Entitles the lender to collect rents directly from the tenants in lieu of the borrower's payment if the borrower defaults on the loan

H. Buying subject to or assuming a seller's mortgage or deed of trust

1. Subject to:
   a. The purchaser is not personally liable for the debt.
b. In the event of a foreclosure, the purchaser is not personally liable for a deficiency.

2. Assumption:
   a. The purchaser is personally liable for the debt.
   b. In the event of a foreclosure, the purchaser may be held liable for any deficiency.
   c. Unless specifically released by the lender, the original borrower may also be liable for the debt or any deficiency.
   d. Loan may not be assumed in many cases without lender approval, requiring assumer to qualify.

I. Alienation clause
   1. Also called a resale clause, due-on-sale clause, or call clause
   2. When the property is sold, the lender can declare the entire debt due immediately.
   3. The lender can raise the interest rate to the market rate.

J. Recording mortgages and deeds of trust
   1. Recorded in the county where the property is located
   2. Gives constructive notice of the debt
   3. Establishes lien’s priority

K. Priority of mortgages and deeds of trust
   1. Priority is established by the date and time of recordation.
   2. Generally, the loan for the purchase is the first lien.
   3. Subsequently recorded liens are second mortgages (junior liens).
   4. Lien priorities can be changed with *subordination* agreements.

V. Provisions of Land Contracts (Installment Contract or Contract for deed)
   A. The buyer (the vendee) agrees to make a down payment and periodic payments of principal and interest and receives equitable title at the signing of the contract.
   B. The seller (the vendor) retains legal title during the contract term and agrees to convey legal title to the buyer when the terms of the contract have been fulfilled.
   C. Contract permits eviction in case of default with seller keeping any money already paid.

VI. Foreclosure—the legal procedure whereby the property pledged as collateral is sold to satisfy the debt
   A. Methods of foreclosure—provisions vary from state to state
      1. Judicial foreclosure—the property may be sold by court order
      2. Nonjudicial foreclosure—used when a power-of-sale clause is contained in the security document
      3. Strict foreclosure—after proper notice is given and the defaulted debt remains unpaid, the court awards legal title to the lender
4. All junior liens are eliminated.

B. Deed in lieu of foreclosure
   1. Sometimes called a "friendly foreclosure"
   2. The borrower forfeits any equity in the property and deeds it to the lender.
   3. Any junior liens remain and become the lender's liability.
   4. Lender loses any rights pertaining to FHA or PMI insurance or VA guarantees.

C. Redemption
   1. Provides the opportunity for a defaulting borrower to redeem the property
   2. Equitable right of redemption—any time before the foreclosure sale, the defaulted borrower can bring the debt current and have it reinstated
   3. Statutory right of redemption—the specific period allowed for redemption after the foreclosure sale; state laws vary widely.

D. Deed to purchaser at sale
   1. Given after any redemption period has expired
   2. Executed by a sheriff or a master-in-chancery
   3. Contains no warranties

E. Deficiency judgment
   1. Issued to cover the difference between the amount received at the foreclosure sale and the principal balance owed
   2. Becomes a judgment against the debtor
Chapter 15
Real Estate Financing: Practice

LECTURE OUTLINE:

I. Introduction to the Real Estate Financing Market

A. Federal Reserve System
   1. Created to help maintain sound credit conditions
   2. Helps counteract inflationary and deflationary trends
   3. Attempts to create a favorable economic climate
   4. Divides country into 12 federal reserve districts
   5. Regulates the flow of money and interest rates
      a. Controls bank reserve requirements
         (1) Funds unavailable for loans or any other use
         (2) Designed primarily to protect customer deposits
         (3) Also provides a means of manipulating the flow of cash into the money market
      b. Controls bank discount rates
         (1) When banks borrow from their district reserve banks, their loan interest rate determines what interest rate they must charge their borrowers.
         (2) A high discount rate reduces consumer borrowing; a low discount rate stimulates consumer borrowing.

II. The Primary Mortgage Market

A. Lenders provide funds to borrowers as investments
   1. Income generated for lender from
      a. Finance charges-loan origination fees and discount points
      b. Recurring income-interest
   2. Selling loans in secondary mortgage market
      a. Generate funds to make new loans
      b. Servicing loans—collecting payments, accounting, bookkeeping, processing payments of taxes and insurance, and following up on delinquencies

B. Thrifts, savings associations and commercial banks
   1. Fiduciary lenders
   2. Subject to regulations set by government agencies such as
      a. Federal Deposit Insurance Corporation (FDIC)
      b. Office of Thrift Supervision (OTS)

C. Insurance companies
1. Invest much of their premium income in profitable enterprises, such as long-term real estate loans
2. Prefer income-producing commercial and industrial properties
3. Invest in residential loans by purchasing large blocks of government backed loans from the Fannie Mae and other mortgage warehousing agencies

D. Credit unions
1. Cooperative organizations that require membership to borrow
2. Only recently started making long-term first and second mortgage loans

E. Pension funds
1. Only recently started making long-term first and second mortgage loans
2. Funds channeled through mortgage bankers and mortgage brokers

F. Endowment funds
1. Commercial banks and mortgage bankers handle
2. Source for financing low-risk commercial and industrial property

G. Investment group financing
1. Very popular for large real estate projects
2. Funds come from such sources as partnerships and investment trusts.

H. Mortgage banking companies
1. originate real estate loans using funds borrowed from others as well as their own funds.
2. often serve as intermediaries between investors and borrowers, but not as mortgage brokers.
3. generally service the loan once it has been made.
4. are usually organized as stock corporations.
5. are usually subject to fewer restrictions than other lenders.

I. Mortgage brokers
1. act as intermediaries between borrowers and lenders.
2. locate borrowers, process their loan applications, and submit them to lenders.
3. do not service the loan once it has been made.
4. consult state’s laws regarding licensure or registration of mortgage brokers.

III. The Secondary Mortgage Market
A. Secondary mortgage market—where loans are bought and sold after they have been funded

B. The originating lender may service the loan for a fee.

C. Agencies: Purchase real estate loans and then assemble them into securities for sale to investors.
D. Fannie Mae
1. A quasi-governmental agency—a privately-owned stock-issuing corporation supervised by the federal government
2. Deals in all real estate loans—FHA, VA, and conventional
3. Buys block or pool of mortgages from a lender in exchange for mortgage-backed securities

E. Ginnie Mae
1. Exists as a division of HUD
2. Administers special assistance programs for real estate loans
3. Works with Fannie Mae in the secondary mortgage market
4. Joins with Fannie Mae to provide "tandem plan" funds in times of high interest rates and tight money
5. Issues the Ginnie Mae pass-through certificates
   a. A security interest in a pool of mortgages
   b. It "passes through" the principal and interest payments directly to the holder of the certificate.
   c. The payments are guaranteed by Ginnie Mae.

F. Freddie Mac
1. Provides a secondary market primarily for conventional loans
2. Sells mortgage-backed securities like Fannie Mae
3. Unlike Ginnie Mae, does not guarantee any payments

G. In Practice: Lenders use Fannie Mae/Freddie Mac standardized forms and follow their guidelines for underwriting procedures for loans they wish to sell them in the secondary mortgage market.

IV. Financing Techniques—although the term "mortgage" is used throughout this chapter, the provisions also apply to deed of trust loans

A. Straight loans
1. Also called "term loans" or "nonamortizing loans"
2. Periodic payments of interest only with the entire principal balance due at the end of the loan term
3. Generally used for home improvement and second mortgages

B. Amortized loans
1. Also called "direct reduction" loan
2. Level-payment mortgages
   a. Each payment is the same dollar amount.
   b. The amount applied to the interest decreases with each payment.
   c. The amount applied to the principal increases with each payment.
3. Regular periodic payments are made, with each payment being applied first to the interest owed and the balance to the principal amount.
4. By the end of the term all the principal has been paid off gradually.
5. Most amortized loans paid in monthly installments; some paid quarterly or semiannually
6. Math Concepts: The mortgage amortization triangle

C. Adjustable-rate mortgages (ARMs)

1. Interest rates fluctuate, and therefore, so do the payments.
2. Components include
   a. interest rate tied to the movement of an index.
   b. interest rate equals the index rate plus a premium, the margin—the lender's profit and cost of doing business.
   c. rate caps that limit the amount the rate can increase both periodically and over the life of the loan.
   d. payment cap that sets the maximum payment amount (might cause negative amortization).
   e. adjustment period that sets how often the rate can be changed.

D. Balloon payment loans

1. The periodic payments are not sufficient to fully repay the principal loan balance by the end of the term of the loan.
2. Characteristic of a partially amortized loan
3. Math Concepts: Balloon payment loan

E. Growing-equity mortgages (GEMs)

1. Known as a rapid-payoff mortgage
2. Increase in payments during the term of the loan reduces the principal amount more rapidly.
3. Borrower’s equity grows faster than normal.

F. Reverse-annuity mortgages (RAMs)

1. Regular monthly payments made to the borrower
2. The accrued debt (principal and interest) becomes payable at some specified future event, such as the sale of the property or by the estate upon the death of the owner.

V. Loan Programs

A. Loans are classified based on the loan-to-value ratio

1. Value based on the sale price or appraisal, whichever is lower
2. Lower the ratio of debt to value, the higher the down payment; a more secure loan, minimizes lender’s risk
3. Math Concept: Determining LTV

B. Conventional loans

1. Loan-to-value ratio lowest; borrower makes significant down payment
2. Security for the loan is provided solely by the mortgage.
3. Payment of debt rests solely on the ability of the borrower to pay based on the borrower’s 
   a. creditworthiness as indicated by credit reports. 
   b. amount of income. 
   c. amount of existing outstanding debt. 
4. Consult lenders for current LTV and borrower ratios.

C. Private mortgage insurance

1. Loan-to-value ratio is higher than for other conventional loans.
2. Additional security for the loan for the lender is provided by private mortgage insurance.
3. 25 to 30 percent of the loan is insured.
4. Borrower pays insurance premiums.
5. Consult lenders for current rates.
6. PMI is to drop automatically when loan-to-value is 22%.

D. FHA-insured loans

1. FHA—part of the Department of Housing and Urban Development (HUD)
2. FHA insures real estate loans made by approved lending institutions.
3. Most common program: Title II, Section 203(b)
   a. For one-to-four-family residences
   b. Borrower or someone else pays mortgage insurance premium (MIP) in cash or it may be financed.
   c. FHA sets standards for the type and construction of buildings and neighborhood and qualifications for borrowers.
   d. The property must be appraised by an FHA-approved appraiser.
   e. FHA sets maximum loan amounts.
   f. Consult local lenders for current loan requirements.
4. Other FHA loan programs—for home improvement purposes, for condominium units, and adjustable rate mortgage loans
5. Prepayment privileges—no penalty to prepay (loans made prior to August 2, 1985 require minimum 30 days' advance notice)
6. Assumption rules—depends on when loan was originated
   a. Loans before December 1986—generally no restrictions
   b. Loans between December 1, 1986 and December 15, 1989—buyer must submit to a creditworthiness review
   c. Loans on and after December 15, 1989—no assumptions without complete buyer qualification
7. Discount points—who pays them and in what amount is negotiable between the parties; concessions exceeding 6 percent of the sales price will trigger a reduction in the property's sales price.

E. VA-guaranteed loans

1. The Department of Veterans Affairs (VA)
   a. Authorizes the guarantee of home loans for eligible veterans
   b. Sets the minimum service times of 90 days, 181 days or two years, depending on the calendar dates of service
   c. Reservists who do not otherwise qualify are also eligible.
2. VA guarantees real estate loans made by approved lending institutions.
3. Financing provisions
   a. Generally, no down payment is required.
   b. There is no limit on the amount of the loan; determined by lender.
   c. Limit on the maximum amount of VA guarantee
      (1) Maximum guarantee amount is $60,000.
      (2) Generally lenders will loan up to four times the veteran's available guarantee amount, or $240,000 maximum.
   d. The veteran must apply for a certificate of eligibility that indicates the maximum guarantee to which the veteran is entitled.
   e. The VA will issue a certificate of reasonable value (the VA approved appraisal)
      (1) to indicate the property's maximum value for guarantee purposes.
      (2) If property appraises for less than the sales price, veteran can make a down payment in cash to make up the difference between the appraisal and sale price.
4. Fees:
   a. Loan origination fee paid to lender
   b. Funding fee paid to VA
   c. Discount points—can be paid by the veteran, seller, or other person
5. Prepayment privileges—can prepay without any penalty
6. Assumption rules
   a. For VA loans made after March 1,1988, the VA must approve the buyer and assumption agreement.
   b. Processing fee is usually $500.
   c. Original borrower remains liable for the loan unless VA approves a release of liability; lender must release separately.
   d. Non-veterans may assume the loan.

F. Farm Service Agency (FSA)
   1. Formerly the Farmers Home Administration, a division of the Department of Agriculture
   2. Provides loans to help purchase or improve properties in rural areas, primarily farms and single-family residences
   3. Has guaranteed loan programs as well as a direct loan program
   4. Loans to low/moderate income families at low interest rates

VI. Other Financing Techniques
A. Purchase-money mortgages
   1. Can refer to any type of real estate financing for the purchase
   2. Often refers to an extension of credit by the seller to the buyer that enables the buyer to purchase the property; the seller "takes back" a note for some or all of the purchase price
B. Package loans
   1. One loan covering both real and personal property
   2. Usually used in new home sales to include the financing for floor and window coverings, major appliances, and other similar items of personal property
C. Blanket loans
   1. are one loan secured by multiple parcels of property as collateral.
   2. are usually used in the financing of subdivision developments.
   3. have a partial release clause that enables borrower to get a release of one of the parcels while the lien remains in place on the other parcels.

D. Wraparound loans
   1. allow the new lender to assume responsibility for the payment of the existing loan (the underlying obligation) and give the borrower a new increased loan at a higher interest rate.
   2. may be prevented by an acceleration and alienation or due-on-sale clause in the original mortgage.

E. Open-end loans
   1. secure a note for a current loan and for any future advances.
   2. allow a borrower to "open" the loan to increase the debt to its original amount.

F. Construction loans
   1. Periodic payments often called "draws"
   2. Made to the general contractor at predetermined progress points
   3. Paid off and replaced by a permanent or "take out" loan

G. Sales and leasebacks
   1. The seller sells the property and leases it back, receiving cash and the use of the property; becomes the lessee.
   2. The buyer receives the income from the rent and an ideal tenant; becomes the lessor.
   3. Transactions usually require expert legal and tax advice.

H. Buydowns
   1. some of the buyer's future interest paid in advance to the lender by the seller or some other individual.
   2. Used frequently by home builders as an incentive to buyers

I. Home equity loans
   1. Usually junior to the loan obtained to purchase the property
   2. Can be an equity line of credit or a fixed amount

VII. Financing Legislation
   A. Truth-in-Lending Act and Regulation Z
   1. Requires lenders to disclose to borrowers the true cost of obtaining credit so that interest rates among lenders can be compared
2. Applies to all loans of $25,000 or less for private consumers
3. Always applies when a residence collateralizes the loan
4. Does not apply to agricultural loans or business or commercial loans over $25,000
5. The consumer must be fully informed of all financing charges, including loan origination fees, finders' fees, service charges, discount points, and interest charges.
6. The lender must compute and disclose the annual percentage rate (APR)—the true cost of the financing to be obtained.
7. For purposes of Regulation Z, a creditor is defined as one who
   a. extends consumer credit more than 25 times a year or more than 5 times a year if the transaction involves a dwelling as security.
   b. subjects the credit to a finance charge or contracts for payments in more than four installments.
8. Three-day right of rescission
   a. applies to most Regulation Z consumer credit transactions.
   b. Does not apply to residential purchase money or first mortgage or deed of trust loans
9. Advertising for real estate financing
   a. Must give the annual percentage rate
   b. APR must include the total finance charges
   c. If any specific loan terms (trigger terms) are mentioned, all terms must be included such as the cash price; required down payment; number, amounts, and due dates of all payments; and the annual percentage rate
10. Penalties for noncompliance include
    a. liability to the consumer for twice the amount of the finance charge with a $100 minimum and a $1,000 maximum.
    b. court costs, attorneys' fees and actual damages.
    c. fines of up to $10,000 for each day a violation continues after an administrative order enforcing Regulation Z is given or for engaging in unfair or deceptive credit practices.
    d. for willful violations, up to a $5,000 fine or one year in prison or both.

B. Equal Credit Opportunity Act (ECOA)
1. Prohibits lenders and those who grant or arrange credit to consumers from discriminating on the basis of
   a. race,
   b. color,
   c. religion,
   d. national origin,
   e. sex,
   f. marital status,
   g. age (provided the applicant is of legal age), or
   h. dependence on public assistance (welfare).
2. Lenders and creditors must inform rejected credit applicants, in writing within 30 days, why credit was denied or terminated.

C. Community Reinvestment Act of 1977 (CRA)
1. Financial institutions are expected to meet deposit and credit needs of community, participate in development and rehabilitation projects and loan programs.

2. Law requires statement by lender
   a. defining geographic boundaries of community,
   b. identifying type of community reinvestment credit offered, and
   c. including comments from the public about lender’s performance in meeting community needs.

D. Real Estate Settlement Procedures Act (RESPA)—created to provide the parties to a residential real estate transaction involving new financing with disclosure of all settlement charges (see Chapter 22)

E. Computerized loan origination (CLO) and automated underwriting
   1. An electronic network for handling loan applications that provides lists of mortgage lenders, rates, and terms
   2. Real estate agent may assist buyer in selection of lender and applying for loan on-screen.
   3. Broker may earn fees up to 1/2 point of loan amount; borrower must pay fee.
   4. Automated underwriting procedures shorten loan approval times,
      a. lower cost of application,
      b. reduce lenders’ time on approval process, and
      c. strengthen buyer’s offer to purchase by including proof of loan approval.
   5. Fannie Mae system called “Desktop Underwriter”; Freddie Mac system called “Loan Prospector”
Chapter 16
Leases

LECTURE OUTLINE:

I. Leasing Real Estate
   A. Definition—Lease
      1. A contract between owner of real estate (lessor) and tenant (lessee) to transfer rights of exclusive possession and use in exchange for the payment of rent and other obligations
      2. The owner retains the reversionary right to possession.
      3. Lessor’s interest is now a leased fee estate plus reversionary right.
   B. Statute of Frauds (Consult your local laws)
      1. In most states, to be enforceable, a lease for more than one year must be in writing.
      2. A lease that can be performed in a lesser period of time is usually enforceable in court even if it is oral.
   C. In Practice: The best practice for the protection of all parties is to use written leases. Any written agreement must be signed by both parties.

II. Leasehold Estates
   A. Estate for years (tenancy for years)
      1. Continues for a definite period of time, regardless of how long
      2. Specific beginning and ending dates
      3. No notice is required to terminate
      4. Does not automatically renew
   B. Estate from period to period (periodic tenancy)
      1. Exists for a fixed period of time but automatically renews itself
      2. The payment and acceptance of the rent extends the lease for another period.
      3. Proper notice must be given to terminate the lease.
      4. Holdover tenancy
         a. created when tenant with estate for years remains in possession.
         b. landlord may evict or treat holdover tenant as one who has periodic tenancy.
   C. Estate at will (tenancy at will)
      1. Exists with the consent of the landlord
      2. Usually informal and oral
      3. Indefinite in length
      4. Proper notice must be given to terminate
      5. Automatically terminates at the death of either party
D. Estate at sufferance (tenancy at sufferance)

1. Created when the tenant who legally obtained the possession of the property now illegally remains in possession
2. Exists without the consent of the landlord
3. Examples
   a. Tenant whose lease has expired but refuses to move out
   b. Owner whose property has been foreclosed but refuses to vacate the premises

III. Lease Agreements

A. Requirements (essential elements) of a valid lease

1. Offer and acceptance—meeting of the minds of the parties
2. Consideration—usually rent but can be labor or other services
3. Capacity to contract—all parties must be legally competent
4. Legal objectives—intent of the contract must be legal

B. A complete description of the premises should be clearly stated, including specific facilities included in the lease; preprinted lease agreements better suited for residential property; commercial lease more complex, legal counsel should be consulted.

C. Possession of premises

1. The covenant of quiet enjoyment for the tenant is implied by law regardless of whether addressed in the lease.
2. Landlord is allowed to enter property with tenant’s permission.

D. Use of premises—if the use is to be limited in any manner, that use must be specifically stated in the lease.

E. Term of lease—dates should be stated precisely

F. Security deposit (consult your local laws)

1. Held by the landlord during the lease
2. Applied to unpaid rent or repairs
3. State or local law may set minimums or maximums
4. In Practice: The lease should specify whether such funds are security deposits or advance payments of rent.

G. Improvements

1. Generally, neither party is required to make improvements.
2. The tenant may make improvements with permission.
3. Any trade fixtures should be identified in the lease.
4. Accessibility
a. Federal Fair Housing Act (see Chapter 20) makes it illegal to discriminate on basis of physical disabilities. Tenants may make reasonable modifications to property but must restore at end of lease term.

b. American with Disabilities Act (ADA) applies to commercial, nonresidential property; requires they be free of architectural barriers or provide reasonable accommodations for people with disabilities.

H. Maintenance of premises

1. Historically, the landlord is not obligated to make repairs.
2. Under current landlord-tenant laws, some jurisdictions require landlords to make repairs on residential units to keep them in habitable condition and maintain the common areas.
3. The tenant must return the premises in the same condition as received, except for ordinary wear and tear.

I. Destruction of premises

1. The tenant is obligated to pay rent if the improvements are destroyed when
   a. The property is agricultural land
   b. In most states, the lease is a ground lease
   c. In some cases, the tenant rents an entire building
2. If part of a building is destroyed, the tenant is usually not required to continue to pay rent.

J. Assignment and subleasing

1. Can be prohibited by the terms of the lease
2. Assignment is the transfer of all of the tenant's interest.
3. Subleasing is the transfer of part of the tenant's interest.
4. Either may require the lessor's consent.
5. The tenant/sublessor's interest in a sublease is known as a sandwich lease.

K. Recording a lease

1. Recording varies according to state laws and the length of the lease; leases of three years or longer generally are recorded.
2. In some states, only a memorandum of lease is recorded.

L. Options

1. The privilege of renewing or extending the lease or purchasing the property at a predetermined price and time
2. The tenant must give notice of intention to exercise the option.
3. The lease is the primary consideration, the option is secondary.

IV. Types of Leases

A. Gross lease

1. The tenant pays a fixed rental amount.
2. The landlord pays all of the property charges.
3. Most often used for residential apartment rentals (may differ by local custom)

B. Net lease

1. The tenant pays a fixed rental amount.
2. The tenant also pays some or all of the property charges (in a triple-net lease, the tenant pays all operating and other expenses).
3. Generally used for entire commercial or industrial buildings and the land on which they are located. Ground leases and long-term leases, too.

C. Percentage lease

1. The tenant pays a fixed amount of rent plus a percentage of the gross income of the business. A gross lease or net lease may also be a percentage lease.
2. The percentage and basis agreed to between the parties
3. Most commonly used in retail locations
4. Specifics vary with the type of business and its location
5. Math Concept: Calculating percentage lease rents

D. Other lease types

1. Variable lease—provides for increases in rent during the lease period
   a. Graduated lease—provides for increases in rent at set future dates in specified amounts
   b. Index lease—periodic increase or decrease in rent based on changes in some economic index
2. Ground lease
   a. Usually involves separate ownership of land and buildings
   b. Allows the tenant to construct a building on land that he or she does not own and use the premises thereafter
   c. Generally set up as a net lease
   d. Typically for terms of 50 up to 99 years
3. Oil and gas lease
   a. The owner receives cash for giving exploration rights.
   b. If petroleum is found, the owner usually receives a percentage of its value as a royalty.
4. Lease-purchase
   a. The tenant leases the property in advance of its purchase usually for tax or financing reasons. Part of the rent is applied toward the purchase price.
   b. The purchase is the primary consideration, the lease is secondary.
5. Agricultural lease
   a. Rent can be paid by the tenant in advance (cash rents).
   b. The tenant and owner can share the profits from the sale of the crop when it is sold (sharecropping).

V. Discharge of Lease

A. Termination

1. No notice is required to terminate a tenancy for years.
2. The parties can mutually agree to cancel the lease.
3. The tenant may surrender the leasehold interest if the landlord is willing to accept it.

4. A tenant who abandons the property is still liable for the terms of the lease, including rent payments.

5. When the owner of leased property dies or the property is sold, the lease does not terminate except for
   a. a lease from the owner of a life estate,
   b. the death of either party to a tenancy at will, or
   c. a sale clause in the lease.

6. Oral and written leases without specific expiration dates require proper notice to terminate as required by law.

7. If a lease is breached, it may be terminated according to state law.

B. Breach of lease

1. If the tenant breaches the lease, the landlord may sue for overdue rent, damages to the premises, or other defaults.

2. Suit for possession—actual eviction
   a. The landlord must serve notice to the tenant; the number of days varies according to law.
   b. If the tenant does not leave peaceably, the court may have the tenant and his or her possessions forcibly removed.

3. Tenants' remedies—constructive eviction
   a. If the landlord breaches the lease, the tenant has the right to sue for damages.
   b. The tenant may abandon the premises if
      (1) The landlord's action or inaction has rendered the premises uninhabitable.
      (2) The tenant must remove himself or herself because of the premises not being usable.

C. Pro-tenant legislation—Uniform Residential Landlord and Tenant Act

1. The result of consumer awareness

2. Adopted by some states

3. Provides that both parties have certain obligations

4. Provides state-specific remedies for both parties

VI. Fair Housing Laws (See Chapter 20)

A. To ensure that all persons have access to housing of their choice, including rentals, within their ability to pay, without differentiation in terms and conditions, because of their race, color, religion, sex, familial status, handicap, or national origin (consult local laws for additional protected classes)

B. Changes in 1988 have significant impact on rental practices:
   1. Protections for people with disabilities
   2. Protections for families with children

C. Examples: cannot segregate individuals in sections of a complex; must allow people with disabilities to alter the premises; cannot charge different amounts of rent or security deposit
Chapter 17
Property Management

LECTURE OUTLINE:

I. The Property Manager

A. Property management—a specialized profession; responsible for
   1. Financial management
   2. Physical management
   3. Administrative management

B. Preserve the value of an investment property while generating income as an agent for
   the owner. Accomplished by
   1. Securing suitable tenants
   2. Collecting the rents
   3. Caring for the premises
   4. Budgeting and controlling expenses
   5. Hiring and supervising employees
   6. Keeping proper accounts
   7. Making periodic reports to the owner

C. Securing management business
   1. Sources of business
      a. Corporate owners
      b. Apartment developers and landlords
      c. Condominium associations
      d. Homeowners’ associations
      e. Investment syndicates
      f. Trusts
      g. Absentee owners
      h. Community associations
   2. Make sure that owners have realistic expectations

D. The management agreement
   1. Description of the property
   2. Time period the agreement will cover
   3. Definition of management’s responsibilities
   4. Statement of owner’s purpose
   5. Extent of manager’s authority as an agent
   6. Reporting—frequency and detail
   7. Compensation—management fee or other compensations; a negotiable percent
      or flat fee or both
   8. Allocation of costs
   9. Equal opportunity housing statement
   10. Math Concept: Rental commissions
II. The management profession

A. The Institute of Real Estate Management (IREM)

B. The Building Owners and Managers Association International (BOMA)

III. Management Functions—in accordance with the management agreement

A. Budgeting expenses. The professional property manager should be certain that the building owner has realistic income expectations and is willing to spend money on necessary maintenance.

1. The budget should be based on anticipated revenues and expenses.
2. Fixed expenses include
   a. employees' salaries and
   b. real estate taxes and insurance premiums.
3. Variable expenses include
   a. repairs,
   b. decorating, and
   c. supplies.

B. Capital expenditures

1. Funds should be set aside for renovations if they will enhance the value of the property over the long term.
2. Life cycle costing: The cost of renovation or equipment to be installed must be evaluated over its useful life, including the initial and future operating costs.

C. Renting the property

1. Using an in-house service ensures control.
2. Using a leasing agent may increase the manager's liability for long-term financial health of the property.

D. Setting rental rates

1. Must cover fixed charges and operating expenses as well as provide a fair return on the investment
2. Must consider the prevailing rates in comparable buildings
3. Must consider the current level of vacancy in the property to be rented
   a. High vacancy level may indicate poor management.
   b. A high occupancy level may indicate rents are too low.
   c. Math Concept: Calculating monthly rent per square foot

E. Selecting tenants

1. The size of the space meets the tenant’s requirements.
2. The tenant has the ability to pay.
3. The tenant's business will be compatible with the building and with the other tenants.
4. If the tenant is likely to expand in the future, expansion space will be available.
5. Landlord must comply with applicable fair housing laws and ADA.

F. Collecting rents

1. Select tenants carefully.
2. Substantiate their ability to pay through their financial references.
3. Maintain a firm and consistent collection plan.

G. Maintaining good relations with tenants

1. Keeping tenants satisfied minimizes turnover and expenses for the landlord.
2. A good property manager will
   a. use tangible and intangible benefits to keep tenants happy.
   b. ensure that maintenance requests are attended to promptly.
   c. enforce all lease terms and building rules fairly.
   d. keep accurate records regarding rental payments and lease expirations.

H. Maintaining the property

1. The property manager must balance the service requirements of the property with the costs they entail.
2. The physical integrity of the property must be protected.
   a. Preventive maintenance—regularly scheduled activities to maintain the structure
   b. Repair or corrective maintenance—fixing items that are broken
   c. Routine maintenance—routine cleaning and repairs
   d. Construction—in nonresidential properties, the alterations to make tenant improvements
3. Hiring employees versus contracting for service—decision based on the size of the building, complexity of the requirements, and availability of suitable labor
4. Tenant improvements: major alterations to meet commercial or industrial property tenant needs

I. Handling environmental hazards

1. Be aware of the possible environmental hazards (cite those common in your area)
2. May arrange an environmental audit
3. Must provide proper disposal of waste
4. May have to provide facilities for recycling

J. The Americans with Disabilities Act

1. Adopt nondiscriminatory employment procedures if have 15 or more employees
   a. Recruitment, interviewing, selection, hiring, promotion, termination, etc.
   b. Providing reasonable accommodations to enable a person with a disability to perform essential job functions
2. Ensuring access to services and facilities for people with disabilities (see Figure 17.1)
   a. Conducting a building audit to determine compliance with ADA
   b. Preparing and executing a plan to retrofit or restructure a building that is not in compliance
   c. Removing barriers and providing accommodations when they can be accomplished in a readily achievable manner

IV. Risk management

A. The property manager must evaluate the perils of any risk by deciding to

   1. avoid it by removing the source of the risk,
   2. control it by taking preventive measures,
   3. transfer it by taking out an insurance policy, or
   4. retain it by insuring with a large deductible.

B. Security of tenants

   1. Recent court decisions held landlords and their agents responsible for physical harm inflicted on tenants by intruders.
   2. Property managers should evaluate measures to protect tenants from unauthorized entry to building and secure individual apartments.

C. Types of insurance coverage

   1. Fire and hazard—can be extended to cover windstorm, hail, smoke damage, and civil insurrection
   2. Consequential loss, use, and occupancy—covers the loss of revenue if the property cannot be used to produce income
   3. Contents and personal property—covers contents and personal property when they are not physically located on the premises
   4. Liability
      a. Public liability—protects the public while on the premises
      b. Workers’ compensation—protects employees while they work either under a state program or a private insurance policy
   5. Casualty—usually written to cover a specific risk, it can cover theft, burglary, vandalism, machinery damage, and health and accident
   6. Surety bonds—cover an owner against financial loss resulting from an employee’s criminal acts or negligence
   7. Multiperil policies—comprehensive packaged insurance program

D. Claims

   1. May be based on depreciated actual or cash value
   2. May be based on current replacement cost
   3. Commercial policies usually include coinsurance clauses
Chapter 18
Real Estate Appraisal

LECTURE OUTLINE:

I. Appraising

A. Appraisal—estimate or opinion of value based on supportable evidence and approved methods

B. Regulation of appraisal activities. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requires appraisals performed as part of a federally related transaction must be performed by a state-licensed or state-certified appraiser.

1. A federally related transaction is any real estate-related financial transaction in which a federal financial institution or regulatory agency engages.
2. Appraisals of residential property valued at $250,000 or less need not be performed by licensed or certified appraisers.
3. Nonresidential properties valued at above $250,000 require a certified appraiser.

C. Competitive market analysis (CMA)

1. Real estate licensees must be familiar with appraisal techniques to perform a competitive market analysis (CMA) when assisting a seller to set the listing price for a property.
2. CMA is not an appraisal.

II. The Appraisal Process

A. State the problem—what type of value is being sought?

B. List the data needed and the sources.

C. Gather, record, and verify the necessary data.

1. General data—national, regional, city, and neighborhood data; data about factors not located on the property
2. Specific data—data on the subject land and improvements
3. Both general data and specific data would include information regarding each of the three approaches to value.

D. Determine the highest and best use of the site.

E. Estimate the land value—usually by sales comparison analysis.

F. Estimate the value by each of the three approaches.

G. Reconcile the estimated values for the final value estimate.

H. Report the final value estimate.
III. The Uniform Residential Appraisal Report

IV. Value—monetary worth based on desirability

A. Characteristics of value ("DUST")

1. Demand—the need or desire for possession or ownership backed by the financial means to satisfy that need
2. Utility—usefulness for its intended purpose
3. Scarcity—a finite or limited supply
4. Transferability—the relative ease with which ownership rights can be transferred

B. Market value

1. The most probable price a property will bring in a fair sale
   a. In a competitive and open market
   b. Buyer and seller each acting prudently and knowledgeably
   c. Price not affected by unusual circumstances
2. Essential to determine market value
   a. The most probable price is not the average or highest price.
   b. The buyer and seller must be unrelated and acting without undue pressure.
   c. Both the buyer and the seller must be well informed of the property's use and potential, including its assets and defects.
   d. A reasonable length of time must be allowed for the property to be exposed in the open market.
   e. Consideration is paid in cash or its equivalent.
   f. Price must represent a normal consideration, unaffected by special financing.

C. Market value versus market price

1. Market value—an estimate based on the analysis of comparable sales and other pertinent market data
2. Market price—what the property actually sells for; sales price

D. Market value versus cost

1. Common misconceptions that cost represents market value
2. Cost and market value may be the same if improvements are new.

E. Basic principles of value—primarily economic principles

1. Anticipation: Value can increase or decrease if one expects that certain events will occur.
2. Change: No physical or economic condition remains constant.
3. Competition: Excess profits tend to attract competition.
4. Conformity: Maximum value is realized if the use of the land is in harmony with existing neighborhood standards.
5. Contribution: The value of any component of a property is what its addition contributes to the value of the whole or what its absence detracts from the value of the whole.
6. Highest and best use—the most profitable single use to which a property can be adapted.
   Must be
   a. Legally permitted
b. Economically (financially) feasible

c. Physically possible

d. Most profitable (maximally productive)

7. Increasing and diminishing returns: Improvements to land and structures will eventually reach a point at which they will no longer have a positive effect on property value.

8. Plottage: The merging or consolidation of adjacent lots held by separate owners into one larger lot may produce a higher total value than the sum of the two lots valued separately.

9. Regression and progression: Between dissimilar properties, the worth of the better property is affected adversely by the presence of the lesser-quality property; usually, the higher-valued property decreases significantly, while the lesser-valued property increases slightly.

10. Substitution: The maximum value of a property tends to be set by the cost of purchasing an equally desirable replacement.

11. Supply and demand. Principle says value depends on
   a. number of properties available in marketplace.
   b. prices of other properties.
   c. number of purchasers.
   d. price buyers willing to pay.

V. The Three Approaches to Value

A. The sales comparison approach

1. An estimate of value is obtained by comparing the subject property (the property under appraisal) with recently sold comparable properties (properties similar to the subject).

2. The factors for which adjustments to the comparable properties are made
   a. Property rights—in cases where less than the full bundle of rights is involved
   b. Financing concessions—events such as differences in mortgage loan terms or owner financing
   c. Market conditions—interest rates, supply and demand and other economic indicators
   d. Conditions of sale—motivational factors such as foreclosure or a sale between family members
   e. Market conditions since date of sale—changes in economic conditions between the date of the sale of the comparable property and the date of the appraisal
   f. Location—compensate for locational or neighborhood differences
   g. Physical features and amenities—physical differences between the comparable properties and the subject

3. A dollar value or percentage adjustment is assigned to each difference between the subject property and the comparable properties.

4. Adjustments are made as follows:
   a. If the comparable property is better than the subject property or has a feature that the subject property lacks, the value of the comparable is decreased accordingly.
   b. If the comparable property is not as good as the subject property or lacks a feature that the subject property has, the value of the comparable is increased accordingly.

B. The cost approach

1. Steps in the cost approach to value
   a. Estimate the value of the land as if it were vacant and available to be put to its highest and best use.
   b. Estimate the current cost of constructing the building(s).
c. Estimate the amount of accrued depreciation resulting from physical deterioration, functional obsolescence, and external obsolescence.
d. Deduct the accrued depreciation from the estimated construction cost of new building(s).
e. Add the estimated land value to the depreciated cost of the building(s) and site improvements to arrive at the total property value.

2. Reproduction cost versus replacement cost
   a. Reproduction cost—the current cost of a duplicate of the subject property, including both the benefits and the negative features of the property
   b. Replacement cost—the current cost of improvements with utility or function similar to the subject property

3. Determining reproduction or replacement cost new
   a. Square-foot method—based on the average cost-per-square-foot or cost-per-cubic-foot of recently built similar structures; also called the comparison method
   b. Unit-in-place method—replacement cost based on the construction cost per unit of the structure's components
   c. Quantity survey method—the cost of the raw materials plus the cost of the construction labor plus indirect costs
   d. Index method—a factor representing the percentage increase or decrease in construction costs to the present time is applied to the original cost of the improvements

4. Depreciation—loss in value of an improvement due to all cause
   a. Physical deterioration—normal wear and tear
      (1) Curable—repairs that are economically feasible
      (2) Incurable—repairs that are not economically feasible
   b. Functional obsolescence—outmoded items and poor design
      (1) Curable—outdated physical or design features that could be replaced or redesigned economically
      (2) Incurable—outdated physical or design features that could not be replaced or redesigned economically or physically
   c. External obsolescence—incurable, because it is caused by a problem external to the property and, therefore, beyond the property owner's control

5. Depreciation is usually calculated on a straight-line basis (economic age-life method), the assumption being that depreciation occurs at an even rate over the structure's economic life

6. Cost approach used for appraising newer or special-use buildings, such as schools, churches, and public buildings.

C. The income approach—based on the present value of the rights to future income

1. Income divided by rate equals value
2. Steps in the income approach to value
   a. Estimate the annual potential gross income—income from all sources, including rent, concessions, and vending
   b. Deduct for vacancies and collection losses ("bad debt") to obtain the effective gross income.
   c. Deduct the annual operating expenses to obtain the net operating income; does not include
      (1) Debt service (principal and interest payments)
      (2) Depreciation (a noncash expense)
      (3) Capital expenditures/capital improvements
d. Estimate the price an investor would pay for the income produced by this particular type and class of property.
   (1) Compare the annual net operating incomes of recently sold similar properties to the sales price of those properties.
   (2) The annual net operating income divided by the sales price results in the capitalization ("cap") rate.
e. Apply the capitalization rate to the subject property's annual net operating income to obtain an estimated value.

3. Gross rent multipliers and gross income multipliers—informal substitutes for income capitalization
   a. Gross rent multiplier (GRM)
      (1) Used for one to four residential units
      (2) Based on the gross monthly rent of recently sold similar properties
      (3) The sales price divided by the gross monthly rent results in the gross rent multiplier
   b. Gross income multiplier (GIM)
      (1) Used for five or more residential unit properties and nonresidential income properties
      (2) Based on the gross annual income (from all sources) of recently sold similar properties
      (3) The sales price divided by the gross annual income results in the gross income multiplier.

D. Reconciliation—obtaining the final value estimate by analyzing and weighing the findings from the three approaches

1. The three approaches to value usually produce three different indications of value.
2. All three should be used in estimating the final value.
3. The three indications of value are not averaged.
4. Depending on type of property, one approach would be given more weight than others.
Chapter 19
Land-Use Controls and Property Development

LECTURE OUTLINE:

I. Land Use Controls
   A. Land use controlled by public and private restrictions and public ownership of land.
   B. The police power of the states is the inherent authority to create the regulations necessary to protect the public health, safety and welfare.
   C. The states, in turn, allow local municipalities to make regulations that are consistent with the general laws.

II. The Comprehensive Plan—also called a master plan
   A. Developed to ensure that social and economic needs are balanced against environmental and aesthetic concerns
   B. Provides the municipality with the goals and objectives for its future development
      1. Land use—that which is proposed for residential, industrial, business, agriculture, traffic and transit, utilities and common facilities, including recreation
      2. Housing needs—that which is anticipated for future residents, including rehabilitation of declining neighborhoods and accommodation of new housing in different dwelling types for households in all income levels
      3. Movement of people and goods—highways, public transit, parking, pedestrian, and bikeway systems
      4. Community facilities and utilities—education, libraries, hospitals, recreation, fire and police, water resources, sewerage and waste treatment, storm drainage and flood management
      5. Energy conservation—reduction in energy consumption and promotion of renewable energy sources

III. Zoning
   A. Zoning ordinances
      1. Local laws that regulate the use of land and structures within designated zones, affecting items such as
         a. Permitted uses of each parcel of land
         b. Lot sizes
         c. Types of structures
         d. Building height
         e. Setbacks
         f. Style and appearance of structures
         g. Density
         h. Protection of natural resources
2. Made possible by state enabling acts
3. No nationwide or statewide zoning ordinances

B. Zoning objectives

1. Zoning classifications generally divide land uses into
   a. residential,
   b. commercial,
   c. industrial,
   d. agricultural, and
   e. multiple-use, such as planned unit developments.
2. Buffer zones—such as parks and playgrounds, may be included to separate
   residential areas from nonresidential areas
3. Certain land use objectives can be achieved with
   a.Bulk zoning—to control density and avoid overcrowding
   b. Aesthetic zoning—to specify certain types of architecture
   c. Incentive zoning—to ensure that certain types of use are incorporated into
      developments
4. Constitutional issues and zoning ordinances
   a. 14th Amendment to the U.S. Constitution prevents states from depriving
      “any person of life, liberty or property, without due process of law.
   b. The tests commonly applied in determining the validity of zoning
      ordinances require that
      (1) the power be exercised in a reasonable manner,
      (2) the provisions be clear and specific,
      (3) the ordinance be free from discrimination,
      (4) the ordinance promote public health, safety and welfare, and
      (5) the ordinance apply to all property in a similar manner.
5. Taking: 5th Amendment - “nor shall private property be taken for public use,
   without just compensation.”
   a. May be negotiated
   b. “Before and after method”
   a. Zoning hearing boards—established to hear complaints about the effects
      zoning may have on specific parcels of property
   b. Nonconforming use—generally applies to properties that conformed with
      the zoning before it was subsequently changed
   c. Variance—a permanent exception to the zoning ordinance
   d. Conditional-use permit—granted to a property owner to temporarily allow
      a special use that is in the public interest

IV. Building Codes

A. Specify minimum construction standards
B. Require building permits and periodic construction inspections
C. Require the issuance of certificates of occupancy
V. Subdivision

A. Subdivision and land development ordinances part of comprehensive plan
   1. Subdivider: buys undeveloped acreage and divides into smaller lots for sale
   2. Developer: constructs improvements on subdivided parcels.

B. Regulation of land development
   1. Controlled by state and local government
   2. State sets minimum requirements; local government has higher standards.
   3. Land development plan must comply with municipality’s comprehensive plan.
   4. Plats
      a. Detailed map showing individual lots
      b. Includes engineering data and restrictive covenants
   5. Subdivision plans
      Zoning ordinances—generally provide for street, road, and highway
      specifications; water main, sanitary sewer, and storm sewer installation;
      easements or right of ways for public utilities; minimum lot sizes and setback
      lines; and areas to be reserved or dedicated for public use
   6. Density zoning ordinances restrict average maximum number of houses per
      acre.
      a. Street patterns (see Figure 19.1)
         (1) Gridiron pattern
         (2) Curvilinear system
      b. Clustering for open space (See Figure 19.2). Developer may choose to
         cluster building lots for open space.

VI. Private Land-Use Controls—to control and maintain the desirable quality and character of a
    property or subdivision

A. Deed restrictions—originated at the time ownership is conveyed (deed) to limit the use

B. Restrictive covenants—included in a subdivision plat or separate recorded document to
   set standards for all the parcels in a subdivision including
   1. The type of building allowed on the property
   2. The use to which the land may be put
   3. The type of construction
   4. Height, setbacks, square footage

C. Legal Issues regarding private restrictions
   1. Restrictions that prohibit the free alienation (transfer) of property ownership are
      usually against public policy and, thus, void and unenforceable.
   2. Restrictions that limit land use are usually valid.
   3. Overly broad and repugnant restrictions are usually overturned by the courts.
   4. If restrictions conflict with the zoning ordinances, the more restrictive of the two
      will take precedence.
   5. Enforcement of private restrictions usually requires an injunction.
   6. Delaying such enforcement can result in laches.
VII. Regulation of Land Sales

A. Interstate Land Sales Full Disclosure Act
   1. Regulates sales of land across state borders
   2. Required to register details with HUD
   3. Must provide purchasers with property report in any development that exceeds 25 lots.

B. State subdivided-land sales laws
   1. Some affect only sale of land located outside the state to state residents
   2. Other states regulate sales of land located both within and outside of state
Chapter 20
Fair Housing and Ethical Practices

I. Equal Opportunity in Housing

A. All real estate licensees must be aware of federal, state, and local fair housing laws.

B. Purpose of the laws is to create an open, unbiased housing market in which every person has the opportunity to live where he or she chooses within his or her ability to pay.

C. Failure to comply with the laws is not only a criminal act but may also be grounds for disciplinary action against a licensee.

D. State and local laws may be more restrictive than federal law.

E. Civil Rights Act of 1866-prohibits any type of discrimination based on race, without exception.

F. U.S. Supreme Court 1896 decision, Plessy V Ferguson established the "separate but equal" doctrine that created classes among citizens because separate was rarely equal.

II. Fair Housing Act (Title VIII of the Civil Rights Act of 1968)–prohibits discrimination in housing; amended by the Housing and Community Development Act of 1974 and the Fair Housing Amendments Act of 1988

A. Protected classes
   1. Race
   2. Color
   3. Religion
   4. Sex
   5. Handicap
   6. Familial status
   7. National origin
   8. Including people who are associated with these individuals

B. Affirmative action and the Equal Housing Opportunity Poster

C. Prohibited actions
   1. Refusing to sell, rent, or negotiate the sale or rental of housing
   2. Changing terms, conditions, or services for different individuals as a means of discrimination
   3. Advertising that restricts the sale or rental of residential property
   4. Representing that a properties not available for sale or rent when in fact it is.
   5. Profiting by inducing owners of housing to sell or rent because of the prospective entry into the neighborhood of persons in the protected classes
   6. Altering the terms or conditions of a home loan or denying a loan as a means of discrimination. Denying membership or participation in any multiple listing service, real estate organization or other facility related to the sale or rental of housing as a means of discrimination
D. Definitions

1. Housing—"dwelling:" any building or part of a building designed for occupancy as a residence by one or more families.
2. Familial status—one or more individuals who have not reached the age of 18 Living with a parent or guardian
   a. All properties available; under the same terms and conditions as for others
   b. Cannot use advertising or occupancy standards with the intent or effect of restricting families with children
3. Disability—physical or mental impairment (or having a history of same) that substantially limits one or more major life activities
   a. Does not include current illegal use of or addiction to a controlled substance nor conviction of the illegal manufacture or distribution of a controlled substance
   b. Does protect individuals in addiction recovery programs
   c. Does protect individuals who have AIDS
   d. Must provide accommodations and allow reasonable modifications that are necessary at tenants’ own expense
   e. See federal and state laws for accessibility guidelines.

E. Exemptions to the Fair Housing Act

1. The sale or rental of a single-family residence when the home is
   a. owned by an individual who does not own more than three such homes at one time
   b. a real estate broker is not involved, and
   c. discriminatory advertising is not used
2. The rental of rooms or units in an owner-occupied one- to four-family dwelling
3. Dwelling units owned by religious organizations may be restricted to people of the same religion if membership in the organization is not restricted on the basis of the protected classes.
4. A private club that is not open to the public may restrict the rental or occupancy of the lodgings that it owns to its members as long as the lodgings are not operated commercially and membership is not restricted on the basis of the protected classes.
5. Housing for older persons is exempt from the familial status protection.
   a. If intended for persons at least 62 years old or:
   b. At least 80 percent of the units are occupied by at least one person at least 55 years of age
6. Jones v. Mayer (based on the Civil Rights Act of 1866)-where race is involved, no exceptions apply
   a. Supreme Court interpretation expanded definition of race to include ancestral and ethnic characteristics.
   b. Affords due process of law for complaints
7. Megan's Law allows local law enforcement agencies to release information about residency of convicted sex offenders

F. Equal Credit Opportunity Act (ECOA)-prohibits discrimination in the granting of credit based on race, color, religion, national origin, sex, marital status or age (if the applicant is of legal age) Americans with Disabilities Act-provides for nondiscriminatory employment procedures and accessibility to goods and services by people with disabilities

1. Title I-employment of qualified job applicants regardless of disability
2. Title III-accessibility to goods and services; barrier free
III. Issues in Fair Housing Practices

A. Blockbusting-inducing homeowners to sell by making representations regarding the entry or prospective entry into the neighborhood by people in the protected classes

B. Steering-channeling home-seekers into or out of particular areas on the basis of race, color, religion, national origin, or other protected class; the effect of limiting choices

C. Advertising-language that indicates a preference or limitation is discriminatory, such as:
   1. Trying to attract one population to exclusion of others
   2. Selection of media that target one population to the exclusion of others

D. Appraising-cannot consider factors related to the protected classes when preparing valuations or appraisals

E. Redlining-refusing to make mortgage loans or issue insurance policies in specific areas for reasons other than the economic qualifications of the applicant

F. Intent and effect-without intention to discriminate, certain activities can have that effect; effects test is applied.

G. Response to concerns of terrorism-landlords and property managers need to take care that security procedures designed to protect against terrorism do not violate fair housing rights

IV. Enforcement of the Fair Housing Act

A. Administered by the Office of Fair Housing and Equal Opportunity (OFHEO) under the direction of the Secretary of HUD.
   1. A complainant has one year after the alleged act of discrimination to file a charge with HUD or two years to bring a federal suit.
   2. HUD will investigate to see if discrimination actually occurred. HUD will attempt to resolve by conciliation.
   3. Unless someone connected with the charge requests that it be heard in federal district court, an administrative law judge from HUD will hear the charge.
   4. The administrative law judge has the authority to issue an injunction, award actual damages and impose civil penalties of
      a. up to $11,000 for first offense,
      b. up to $27,500 for second offense within 5 years, or
      c. up to $55,000 for further violations within 7 years.
   5. Cases heard in federal court can result in the award of actual and unlimited punitive damages.
   6. Complaints brought under Civil Rights Act of 1866 are taken directly to federal court

B. State and local enforcement agencies
   1. Many states and municipalities have own fair housing laws.
   2. All complaints filed with HUD referred to local enforcement agencies if their laws are substantially equivalent with federal law.

C. Threats or acts of violence-the Fair Housing Act protects those who seek or encourage the exercise of open housing rights.
V. Implications for Brokers and Salespeople
   A. Real estate industry largely responsible for creating and maintaining open housing market.
      1. Social as well as legal responsibility
      2. Reputation of industry cannot afford even the appearance of illegal discrimination.

   B. Good business practices will minimize the potential for charges of discrimination.
      1. Office policies and procedures to avoid discrimination
      2. Standardized inventory of property listings
      3. Consistent practices
      4. Written documentation of all aspects of a transaction
      5. Brokers should ask themselves "Are we doing this for everyone?"
      6. The broker should display the equal housing opportunity poster.

VI. Professional Ethics

   A. Professional conduct involves more than compliance with the laws.
      1. State license laws establish activities that are illegal.
      2. Ethics is a system of moral principles, rules, and standards of conduct; goes beyond merely complying with the law.

   B. Codes of ethics are written systems of standards for ethical conduct-specific in dictating rules that either prohibit or demand certain behavior; must provide sanctions for violators.
      1. Example-Code of Ethics of the National Association of REALTORS® for its membership.
      2. Some states require real estate commissions to establish codes or canons of ethical behavior.
Chapter 21
Environmental Issues and the Real Estate Transaction

LECTURE OUTLINE:

I. Environmental Issues

A. Need to balance commercial use of land with preservation of vital resources and protection of the quality of water and soil.

B. Prevention and cleanup of pollutants and toxic wastes revitalize land and add greater opportunity for responsible development.

C. Environmental issues are important in practice of real estate
   1. Consumer more health and safety conscious.
   2. Licensees must be alert to existence of environmental hazards.
      a. Disclosure at time of transfer of property
      b. Familiar with state and federal environmental laws and regulatory agencies
      c. Disclosure at time of transfer of property
      d. Familiar with state and federal environmental laws and regulatory agencies

II. Hazardous Substances

A. Asbestos
   1. Once used as insulation; banned in 1978
   2. About 20 percent of the nation’s commercial and public buildings contaminated.
   3. Health hazard
      a. Inhaling
      b. Harmful only when disturbed or exposed
      c. Highly friable
      d. No safe level of asbestos exposure
   4. Used also in residential properties
      a. To cover pipes, ducts
      b. Fire resistant property made it popular
   5. Costly to remove
      a. Requires state licensed technicians and specially sealed environments
      b. Disposal at licensed facilities
      c. Encapsulation, or sealing off of disintegrating asbestos, may be preferable method of containment.

B. Lead-based paint and other lead hazards (see Figure 21.2)
   1. Lead used as paint pigment.
   2. Present in about 75% of private housing built before 1978.
   3. Elevated levels in body cause serious damage to brain, kidneys, nervous system and red blood cells.
4. Lead particles can be present anywhere in soil and ground water
5. Use of lead-based paint banned in 1978
6. No federal regulations that homeowners test for presence of lead-based paint.
7. EPA and HUD regulations require disclosure of any known lead-based paint hazards to potential buyers and renters. Must attach form to all residential leases and sales contracts along with hazard pamphlet.

C. Radon

1. Caused by natural decay of other radioactive substances.
2. Hazardous when trapped in buildings in high concentration.
3. Colorless/tasteless—impossible to detect without testing.
4. Levels of radon can be reduced by installing ventilation systems or exhaust fans.
5. Home radon-detection kits available. Most accurate testing by radon detection professionals.

D. Urea-formaldehyde (UFFI)

1. Primarily used in insulation. Also found in some glues, resins, pressed wood, etc.
3. Ban reduced to warning by courts.
4. Causes several health problems.
5. Tests can be conducted to determine presence of or level of formaldehyde gas in home.

E. Carbon monoxide

1. Colorless, odorless gas byproduct of burning fuels due to incomplete combustion.
2. Improper ventilation of equipment, malfunction creates problems.
3. Detectors are available, mandatory in some areas.

F. Polychlorinated biphenyls

1. Often used as insulating material in dielectric oil. May be present in electrical equipment such as transformers and fluorescent light ballasts.
2. Linger in environment a long time and are suspected of causing health problems
3. Manufacture and commercial distribution of PCBs banned in 1979 Hazardous if present in leaking containers stored on a site

G. Mold

1. Can grow on almost any organic substance if moisture and oxygen are present
2. Gradually destroys what it is growing on and also causes serious health problems. Trigger allergic reactions and asthma attacks. Also produce potent toxins and irritants.
3. Construction practices that result in tightly sealed buildings may prevent adequate ventilation and promote mold. Other causes are roof leaks, unvented combustion appliances, and outside water being directed into building by gutters or landscaping.
4. EPA has published guidelines for remediation or clean-up.
5. Number and size of lawsuits growing
H. Electromagnetic Fields

1. Produced by electric currents
2. Controversy over claims whether they cause health problems. Major concern is high-tension power lines over property.
3. Buyers reluctant to purchase property near power lines/transmitters

III. Groundwater Contamination

A. Contamination of underground water threatens supply of pure clean water for private wells or public water supplies.
   1. Contamination comes from run off from waste disposal sites, leaking underground storage tanks, use of pesticides and herbicides.
   2. Contamination can spread far from source.
   3. Numerous state and federal regulations exist.

IV. Underground Storage Tanks

A. Three to five million underground storage tanks (USTs) in the United States
   1. Commonly found
      a. Where petroleum products used or gas stations/auto repair shops located
      b. Commercial/industrial establishment
      c. Printing/chemical plans
      d. Wood treatment, paper mills
      e. Paint manufacturers
      f. Dry cleaners/food processing plants
      g. Chemical or other process waste storage facility
      h. Military bases and airports
      i. Residential heating oil tanks
   2. Currently in use or abandoned. Once common to bury toxic waste

B. State and federal regulations
   1. EPA regulates tanks that contain hazardous substances or petroleum products and that store at least 10 percent underground.
   2. UST owners are required to register tanks and adhere to requirements that prevent pollution
   3. Regulations govern:
      a. Installation
      b. Maintenance
      c. Corrosion prevention
      d. Overspill prevention
      e. Monitoring
      f. Record-keeping
4. Exemptions
   a. Tanks less than 110 gal.
   b. Farm/residential tanks that hold 1,100 gallons or less of motor fuel used for noncommercial purposes.
   c. Heating oil tanks for on-site use
   d. Tanks in basement (on or above floor of underground area)
   e. Septic tanks
5. Some state laws more stringent than federal laws

V. Waste Disposal Sites
   A. Landfill used as disposal site for garbage.
      1. Layering process used.
      2. Capping by laying 2-4 feet soil of over top and planting grass or other vegetation.
      3. Ventilating with pipe through cap to release accumulation of natural gas.
   B. Federal, state, and local regulations govern location, construction, content, and maintenance
   C. In Practice: location close to garbage incinerator and waste disposal site lowers market value of homes.

VI. Old Industrial Sites
   A. Brownfields—defunct, derelict or abandoned commercial or industrial sites. Many have toxic wastes.
   B. Legislation became law in 2002. Gives state and localities up to $250 million a year for five years to clean up polluted industrial sites.
   C. Law shields innocent developers from liability for toxic wastes at site prior to purchase. Intended to encourage development of such sites.

VII. CERCLA and Environmental Protection
   A. Comprehensive Environmental Response, Compensation and Liability Act
      1. Created “SuperFund” ($9 billion)
      2. Created process by identifying responsible parties (PRPs) and ordering them to take responsibility
      3. Administered by EPA
   B. Liability is strict, joint and several and retroactive
      1. Landowner held responsible for cleanup regardless of whether responsible for contamination
      2. Cleanup of own property and any neighboring property
      3. If not responsible can seek recovery of costs from previous landowners or other responsible party or the SuperFund
      4. If PRP do not voluntarily undertake cleanup, EPA can hire contractors, then bill PRP.
C. Superfund Amendments and Reauthorization Act (SARA)

1. Amended act clarifies obligation of lenders.
2. Innocent landowner immunity: criteria created by which to judge if person or business could be exempt from liability.
   a. That pollution caused by 3rd party
   b. Property acquired after the fact
   c. No actual or constructive knowledge of damage by landowner
   d. “Due care” exercised
   e. Responsible precautions taken in exercise of ownership rights

VIII. Liability of Real Estate Professionals

A. Actual and potential liability

1. Sellers carry the most exposure.
2. Buyers may be held liable.
3. Lenders may end up owning property.
4. Real estate professionals are held liable for improper disclosure.
5. Appraisers must identify problems; responsible to lenders who rely on them to identify.
6. Insurance carrier may be affected.
   a. Mortgage insurance will protect lender.
   b. Hazard insurance carrier may be directly responsible for damage if coverage included in policy.

B. Discovery of environmental hazards

1. Real estate licensees must be aware of possible hazard and where to look for professional help.
2. Ask owner if tests were done.
3. Seek scientific or technical experts.
   a. Environmental audit
   b. Trained inspectors

C. Disclosure of environmental hazards

1. State laws require disclosure.
2. Licensees may be liable if they should have known of a condition even if seller did not disclose.
Chapter 22
Closing the Real Estate Transaction

LECTURE OUTLINE:

I. Preclosing Procedures

A. Closing is the consummation of the real estate transaction

   1. Promises made in sales agreement fulfilled
   2. Mortgage loan funds distributed
   3. Title transferred

B. Buyer’s issues. The buyer will want to be assured that

   1. The seller is delivering good title.
   2. The property is in the promised condition. Inspecting
      a. The title evidence
      b. The seller’s deed
      c. Any documents regarding removal of liens and encumbrances
      d. The survey
      e. The results of property inspection
      f. Any leases

C. Final property inspection to make certain

   1. Necessary repairs made
   2. Property well maintained
   3. Fixtures in place
   4. No unauthorized removals or alterations

D. Survey

E. Seller’s issues. The seller will want to be assured that

   1. the buyer has obtained the stipulated financing.
   2. the buyer has sufficient funds to complete the sale.

F. Title procedures

   1. The buyer needs to be assured that the seller’s property and title comply with the
      sales contract requirements.
   2. The seller is usually required to show proof of ownership by producing current
      title evidence (form that is customary in your area).
   3. The title or abstract company usually makes two title searches.
      a. The first shows the seller’s status as of the contract date.
      b. The second is made for the date the deed is recorded.
      c. The seller may be required to execute an affidavit of title.
II. Conducting the Closing

A. Terminology varies by geographic region

1. Settlement and transfer
2. Passing the papers
3. Closing escrow

B. Face-to-face closing—the gathering of the parties interested in the real estate transaction at which the promises made in the real estate sales contract are kept or executed

1. Two issues are resolved
   a. The closing of the buyer's loan
   b. The closing of the sales transaction
2. May be held at
   a. The title insurance company
   b. The lending institution
   c. One of the parties' attorneys office
   d. The broker's office
   e. The county recorder (or other local recording official) office
   f. The escrow company
3. May be attended by
   a. The buyer
   b. The seller
   c. The real estate licensees (brokers and salespeople)
   d. The attorney(s) for the seller and the buyer
   e. The representative of the involved lending institutions
   f. The representative of the title insurance company

4. The closing agent or closing officer—the person who presides over the closing

5. The exchange; made when all parties satisfied that everything is in order

C. Closing in escrow

1. The method of closing in which a disinterested third party is authorized to act as the escrow agent and coordinate the closing activities.
2. Because the escrow agent is placed in a position of trust, many states have laws regulating escrow agents and limiting who may serve in this capacity.

D. Escrow procedure

1. After escrow agent selected and contract signed, broker deposits earnest money with escrow agent.
2. Before the closing, the seller will deposit with the escrow agent
   a. the deed conveying the property to the buyer;
   b. title evidence (whatever is customary in your area);
   c. existing hazard insurance policies;
d. a letter from the lender and an estoppel certificate stating the exact principal remaining if the buyer is assuming the seller's loan;
e. affidavits of title (if required);
f. a payoff statement if the seller's loan is to be paid off; and
g. other documents necessary to clear the title or complete the transaction.

3. Before the closing, the buyer will deposit with the escrow agent
   a. the balance of the cash needed to complete the purchase, usually in the form of a certified check;
   b. loan documents if the buyer is securing a new loan;
   c. proof of hazard insurance, including, if required, flood insurance; and
   d. other documents necessary to complete the transaction.

4. The escrow agent is given the authority to examine the title evidence
   a. If the title is marketable and all other conditions are met, the escrow agent will disburse the funds and record the documents.
   b. If the title has liens, they will be paid off first.
   c. If the sale cannot be completed, the parties will be restored to their former status.

E. IRS reporting requirements—Form 1099-S
   1. Contains the seller's social security number, sales price, and the amount of property tax that was reimbursed to the seller by the buyer
   2. Must be filed by the closing agent; if this person does not, the responsibility rests on the mortgage lender or ultimately the brokers involved.

F. Broker's role at closing—varies from simply collecting the commission to conducting the proceedings

G. Lender's interest in closing—to protect its security interest in the property, the lender can require
   1. A title insurance policy
   2. A fire and hazard insurance policy
   3. A survey
   4. A termite or other inspection report
   5. A certificate of occupancy (for newly constructed buildings)
   6. Reserve or escrow accounts for tax and insurance payments
   7. Representation by its own attorney at the closing

III. RESPA Requirements

A. Purpose
   1. To provide consumers with greater and more timely information on the nature and costs of settlement
   2. To eliminate "kickback" and other referral fees that tend to unnecessarily increase the costs of settlement
B. RESPA requirements must be complied with when the purchase of a one-to-four-family residential unit is financed by a federally related new first mortgage loan.

1. Made by a federally chartered lending institution
2. Made by an institution whose deposits are federally insured
3. FHA-insured
4. VA-guaranteed
5. Administered by HUD
6. Intended to be sold to Fannie Mae, Ginnie Mae, or Freddie Mac

C. Exceptions to the "new loan" requirement

1. Purchase money mortgage taken back by the seller
2. Installment sales (land contracts)
3. Buyer’s assumption of existing mortgage
4. No exception if
   a. The terms of assumed loans are modified
   b. Assumed loans for which the lender charges more than $50 for the assumption

D. Controlled business arrangements (CBAs)—affiliated firms offer package of services to consumers

1. The relationship between the firms must be disclosed in writing to consumers.
2. Consumers must be free to obtain the services elsewhere.
3. Fees are not exchanged among the affiliated companies simply for the referral of business.

E. Disclosure requirements

1. The lender must give a copy of special informational HUD booklet to every person from whom they receive or for whom they process a loan application.
2. Within three business days of the loan application, the lender must provide the borrower with a good-faith estimate of the settlement costs the borrower is likely to incur.
3. The loan closing information must be prepared on the Uniform Settlement Statement (Form HUD-1) and available for inspection at or before settlement.

F. Kickbacks and referral fees

1. Kickbacks and unearned referral fees are prohibited.
2. The payment or receipt of any fee or thing of value where no service is actually rendered is prohibited.

IV. Preparation of Closing Statements

A. How the closing statement works

1. A debit is a charge (an expense).
2. A credit is an amount entered in a person’s favor.
B. The buyer’s debits and credits are totaled; when the credits are subtracted from the debits, the difference is the cash the buyer must bring to the closing.

C. The seller’s debits and credits are totaled; when the debits are subtracted from the credits, the difference is the amount the seller will receive at closing.

D. Expenses

1. Broker’s commission
2. Attorney’s fees
3. Recording expenses
4. Transfer tax
5. Title expenses
6. Loan fees
7. Tax reserves and insurance reserves (escrow or impound accounts)
8. Appraisal fees
9. Survey fees
10. Additional fees

V. Prorations — expenses divided between the seller and the buyer, including accrued items (such as real estate taxes) and prepaid items (such as fuel oil in a tank)

A. The arithmetic of prorating—four considerations
   1. The nature of item being prorated
   2. Whether it is an accrued item requiring determination of earned amount
   3. Whether it is a prepaid item that requires the unearned amount refunded
   4. What arithmetic processes must be used.

B. Accrued and prepaid items

1. Accrued items = buyer credit
2. Prepaid items = seller credit

C. General rules for calculating prorations

1. The yearly charge is divided by 360-day year (commonly called a banking year) or 12 months of 30 days each.
2. The yearly charge is divided by 365 (366 in a leap year) to determine the daily charge; then the actual number of days in the proration period is determined; and this number is multiplied by the daily charge.
3. The final figure will vary depending on the method used and the number of decimal places to which the division is carried.
4. Guidelines
   a. In most states, the seller owns the property on the day of closing and prorations are made to and including that date.
   b. Prorations are computed using a 30-day month and a 360-day year or using the actual number of days in the month in a 365-day year (refer to area practices).
   c. Accrued real estate taxes are usually prorated; special assessments for public improvements are not.
   d. Rents are usually prorated based on the actual number of days in the month of closing.
e. Security deposits belong to the tenants and must be transferred intact from the seller to the buyer.

5. Real estate taxes
   a. If they are paid in advance, the seller should be reimbursed for the portion of the year remaining after the buyer takes ownership.
   b. If they are paid in arrears, the buyer is credited for the time the seller was occupying the property.

6. Mortgage loan interest—usually paid in arrears

VI. Sample Closing Statement

A. Basic information of offer and sale

B. Computing the prorations and charges

C. The Uniform Settlement Statement (Form HUD-1)