Contents

UNIT 1
The Nature, Description, and Use of Real Estate  1

UNIT 2
Rights and Interests in Land  19

UNIT 3
Ownership and Title Transfer  35

UNIT 4
Recordation, Title Insurance, and Settlement  51

UNIT 5
Real Estate Contracts  71

UNIT 6
Appraisal  89

UNIT 7
Mortgages, Deeds of Trust, and Lending Practices  107

UNIT 8
Government Loan Programs, Income Taxes, and Fair Housing  127

UNIT 9
Agency and Listings  147

UNIT 10
Final Exam Study Guide  165

APPENDIX
Answers to Fill-Ins  169

Glossary  201
The Nature, Description, and Use of Real Estate

LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- discuss the concepts of land and ownership rights in real property;
- distinguish between real and personal property and how they are transferred;
- identify and explain the methods for describing land and real property;
- explain how land use is classified and affected by restrictions tied to police power, zoning deviations, and disclosures; and
- demonstrate how to calculate square footage and the frontage/street front of a property.

Study Plan

Before Class:
Complete the reading assignment in Modern Real Estate Practice listed in the MREP Workbook Reading Guide.
Read the Unit 1 Key Points (on the following page).

After Class:
Complete the Glossary Review.
Complete the Review Exam.
There are two types of property: real property and personal property. Real property is the land, anything affixed to the land, and rights and interests in the land. Real property is conveyed by a deed.

Personal property includes all items not attached to the land that may or may not be conveyed when the property is sold. Each item of personal property is listed in and conveyed by a bill of sale.

Rights and interests in the land include air rights, water rights, mineral rights, oil and gas rights, and support rights. Improvements may be natural (growing) or man-made (fixtures). Personal property attached to the improvements becomes a fixture. Land is not classified as a fixture.

The tests for distinguishing fixtures from personal property are based on determining the intent of the parties. The tests include the method of attachment, adaptation of the item to the property, the relationship of the parties, and any provisions in a written agreement. Fixtures are considered real property and are conveyed in the deed.

Land has physical and economic characteristics that help to determine the value. Location, scarcity, improvements, and area preference all are used to help determine the value of a parcel of land.

A potential disadvantage to real estate ownership is that land is not a liquid asset.

All valid deeds must contain a legal description of the land being conveyed. There are three major types of legal descriptions: metes and bounds, rectangular survey, and recorded plat.

The metes-and-bounds method describes land by a series of courses (compass directions) and distances. It starts at a defined “point of beginning” and then describes the boundaries of the parcel until an enclosed tract of land has been described.

The rectangular survey (or government survey) describes land by reference to a series of grids. A series of ranges, tiers, and townships relative to a principal meridian and a base line are used to locate the property.

The recorded plat method describes land by referring to a lot number on a plat map that has been filed and recorded with the county recorder. Because the plat map contains a detailed description of the land, simple reference to the plat map is sufficient. This method is also called the lot and block or the subdivision plat method.

A survey or an improvement location certificate (ILC) may be used to establish and find property boundaries. Both documents will also identify encroachments.

The purpose of land use controls is to alleviate problems caused by haphazard, unplanned growth of urban areas and to promote more rational development in the future.

Zoning laws are also meant to protect the health and safety of the community’s inhabitants. Buffer zones are used to separate areas with incompatible uses.

The purpose of building codes is to protect the public health and safety. Building codes set minimum standards for construction materials, plumbing and electrical codes, and the structural integrity of a building. A building permit must be granted before construction can begin. A certificate of occupancy will be issued once the building is complete and a final inspection verifies that the builder has complied with the codes.

Zoning ordinances, which are set at a local level, may be amended. A zoning amendment must be justified by the needs of the community.
- A nonconforming use is a pre-existing use that was already legally in place when a new zoning ordinance came into effect, and now the use does not comply with the requirements of the new law. Although nonconforming uses are generally allowed to remain, they may be subject to certain restrictions. A non-conforming use usually cannot be rebuilt if it is destroyed.

- A variance is permission to build a structure or use property in a way that would not otherwise be allowed. Variances are usually granted when strict compliance with the zoning ordinance would cause undue hardship to the property owner.

- A zoning authority can issue conditional use permits (special use permits) for uses that would ordinarily not be allowed in a zone. Permits are granted subject to conditions that limit the adverse effects of the use on the neighborhood.

- Buyers should call the local zoning department to verify that the use they anticipate for the property is allowed.
I. REAL ESTATE/REAL PROPERTY

A. Key points

1. Real property is immovable.

2. Real property includes land plus appurtenances that benefit the land.
   a) ____________ are attached to and run with the land.
   b) All appurtenances, improvements, rights, interests, privileges, and fixtures will automatically transfer to the new owner, via a deed, when the property is sold.

B. Land

1. ____________ rights
2. ____________ rights
3. ____________ rights

C. Improvements

1. Items __________________________ with the intent of __________________________
   a) Examples: ____________, ____________, road, landscaping

D. Rights

1. Three forms of rights
   a) Rights in land, such as air, water, and mineral rights
   b) Rights of ownership, such as the right of an owner to possess, transfer, and control the property
   c) Governmental rights, which give the government the right to determine land use, set taxes, and take back property through eminent domain or escheat (governmental rights and ownership rights will be covered in Unit 2)

2. Rights in land
   a) Air rights
      (1) Rights extend as high as can reasonably be used.
      (2) Government controls air space.
      (3) Owners may not interfere.
b) Water rights
   
   (1) The government controls water rights and grants permits for the use of water, such as irrigation, under ________________.

   (a) Riparian—______________________________

   (b) Littoral—______________________________

   i) Note: Both are often tied to navigation rights.

   (c) Accretion—addition to land through natural causes

   (2) Water rights do not include the right of access. The owner of a water right would not have the right to cross another's property and would need to obtain an easement to do so.

   (a) Right of use

   c) Mineral rights (subsurface rights)

   (1) These rights may be transferred when property is sold or reserved by the seller.

   (2) They are often held by a ________________.

3. Real estate—transferred by a ________________

II. PERSONAL PROPERTY (CHATTEL)

A. Key points

   1. All property that is not real property

      a) is movable,

      b) is not permanently ________________, and

      c) typically does not transfer with the real estate.

      (1) Must be ________________ in the purchase agreement to convey with the property

   2. Personal property is transferred by a ________________.

III. LAW OF FIXTURES

A. Fixture

   1. A fixture is an object that was once personal property that has been ________________ so as to become real property.

   2. Land is never a ________________.

   3. Once the fixture (personal property) is attached, it becomes an ________________ and is automatically transferred in the deed.
B. Test for intent

1. Was the object affixed or installed with the apparent _________________ of improving the land?

2. Intent is evidenced by the following:
   a) Attachment
      (1) Permanence of method
      (2) _________________ = fixture; _________________ = personal property
   b) Adaptation
      (1) Specific to individual property
      (2) Examples: _________________
   c) Agreement
      (1) The _________________ regarding the items is the final decision on what will be conveyed.
      (2) Fixtures must be _________________ from the purchase agreement if the seller is not going to convey.
      (3) The size, value, or location of the item is not important in determining if an item is a fixture.

C. Exceptions—personal property

1. Trade fixtures are tenant-installed additions that are a necessary part of the tenant’s trade or business.
   a) Tenants may remove trade fixtures prior to lease termination.
   b) If not removed by lease termination, the trade fixtures belong to the landlord.

2. Emblements are annually cultivated crops that belong to the party who planted them, unless otherwise agreed.

3. If trade fixtures or emblements are transferred, they will be by a bill of sale.

4. Remember to treat personal property and fixtures as follows:
   a) Personal property must be _________________.
   b) Fixtures must be _________________.

IV. PHYSICAL AND ECONOMIC CHARACTERISTICS OF LAND

A. Physical characteristics

1. Immobile—can’t be moved
2. Indestructible
3. Unique (nonhomogeneous/heterogeneous)—all parcels differ geographically
B. Economic characteristics

1. Scarcity
   a) Although there is a substantial amount of unused land, supply in a given location can be limited.

2. Improvements
   a) Placement of an improvement on a parcel of land affects the value and use of neighboring parcels.

3. Permanence of investment
   a) Sale of a particular parcel of land may take considerable time.
   b) ...

4. Area preference
   a) People's choices and desires for a given area make one site more desirable than another.

V. LEGAL/FORMAL METHODS OF LAND DESCRIPTION

A. Most common methods

1. The three most common are metes and bounds, rectangular (government) survey, and recorded plat.

2. Legal descriptions do not describe improvements, only the land.

3. Improvements and appurtenances are automatically included in land descriptions.

4. Street addresses are informal descriptions that can change, so they are not considered legal descriptions that convey ownership, but they may be used in a lease.

B. Survey

1. A survey is used to...
   a) It is an on-site measurement of property lines and the location of houses, easements, and encroachments.
   b) It uses monuments, which are visible markers that establish...

2. An improvement location certificate (ILC) or mortgage survey locates improvements on the property, but is not used to legally set the property boundaries.
   a) Both will reveal and zoning violations, such as a setback requirement.
C. Metes and bounds (see Figure 1.1)

FIGURE 1.1
Metes and Bounds

Commencing at the permanent reference mark at the Southwest corner of Section 15, thence North 80°0’0” East 152.0 feet to the point of beginning of the property described herein. Thence South 80°0’0” East 180.0 feet; thence South 15°0’0” West 160.0 feet; thence South 85°0’0” West 151.0 feet; thence North 4°11’8” East 199.5 feet to the point of beginning.

1. Metes: __________________________________________________________________________

2. Bounds: __________________________________________________________________________

3. Monuments: fixed objects that serve as __________________________________________________________________________ for the surveyor when setting boundaries

4. Begins and ends at __________________________________________________________________________
   a) It is the only description that uses __________________________________________________________________________
   b) The description must completely encircle the property.

5. Measure in clockwise direction
D. Rectangular (government) survey (see Figure 1.2)

1. A rectangular (government) survey is a system developed by the U.S. government that locates a parcel of land within a grid system, based on its location with reference to meridians and ranges (which run north-south) and base lines and tiers (which run east-west).

2. Meridian and base lines are large imaginary reference lines.

3. A township is a square formed by the meeting of ranges and tiers (6 miles by 6 miles) (see Figure 1.3).

4. A __________________________ is a vertical row of townships (north-south).

5. A __________________________ is a horizontal row of townships (east-west).


7. A section is 1 mile by 1 mile square and contains __________________________.

8. An acre contains __________________________ square feet.
E. Recorded map “plat” (see Figure 1.4)

FIGURE 1.4

Plat Map

1. The plat map is also called the “lot, block, subdivision system” or the “lot and block system.”

2. A plat is a ___________ showing the location and boundaries of individual lots in a land subdivision.

3. Once the final map is approved, but prior to building, ___________________________ in the county recorder’s office of the county in which the property is located.

4. This system is most common in ___________________________ areas.

5. Recording a subdivision plat is the common way for streets in developments to become dedicated for public use.

VI. GOVERNMENT LAND USE CONTROLS

A. Master (comprehensive or general) development plan

1. Land surveys show the present and future use of properties.

2. Economic surveys show the present and future economic base of the area.

3. Master development plans are used to ___________________________.

B. Land use classifications (set by zoning laws)

1. Residential

2. Commercial

3. Industrial/manufacturing

4. Agricultural

5. Mixed

a) Note: A ___________________________ is an area of land that separates two significantly different land use zones. Parks and open spaces are often used as buffer zones.
C. Land use restrictions tied to police power

1. The purpose of these restrictions is to protect against uncontrolled growth, protect public health, and preserve compatibility.

2. All new construction and most renovations require a ____________________.
   a) Building permits are used to ensure that property owners are in ____________________.
      (1) The state sets minimum construction and safety requirements.
      (2) City or county codes may be more restrictive than the state code.
   b) A proposed building must first comply with zoning, or owner will have to seek a zoning change.

3. Building codes are primarily concerned with the structural integrity and ____________________.
   a) Codes determine the types of construction materials that can be used.
      (1) Sets standard for types of materials and how they are used
      (2) Separate codes for plumbing, electrical, fire, and so on
   b) If there is a difference between the national, state, or local building codes, the most stringent is used.

4. ____________________ (COs) are obtained after fulfilling all the requirements of the building permit.

5. Setback/side-yard/rear-yard restrictions specify the location of improvements in relation to boundaries.

6. Building sites have minimum frontage requirements so the government can provide services.

7. Floodplains, coastal preservation, and other special use classifications may be regulated at a local, county, state, or federal level.

8. Flood insurance is typically purchased separately from a standard homeowners policy.

D. Zoning changes/deviations—how land is used

1. Zoning laws and ordinances are set at a local (city or county) level.
   a) Specifies the types of construction allowed
      (1) Single-family, multifamily, or mixed use
      (2) Style, height, and types of construction
   b) Identifies the location and placement of improvements on the property (setbacks)
   c) Illegal use of building codes or a zoning violation does not become legal or acceptable because a certain amount of time has passed; they are not “grandfathered” in
   d) Buyers should be told to verify that the zoning will meet their needs before closing
2. An amendment is a zoning change for an entire area.
   a) Could cause ______________________________

3. Nonconforming use allows the owner to continue present use that no longer complies with current zoning, which is often known as ______________________________ or a grandfather clause.
   a) Owner may not enlarge improvements, or rebuild if improvements are destroyed
      (1) Example: A retail store in a residential neighborhood
      (2) Transfer of title may require new owner to meet current zoning use

4. A variance allows an individual owner to vary or deviate from strict compliance with zoning in order to relieve or prevent economic hardship.
   a) Does not change regulation
   b) Example: A home allowed to be built into the setback

5. Conditional use or special use permits allow a particular property to be used for a special purpose that is in the public's best interest.
   a) Example: ______________________________ in residential zoning

6. Overlaying zoning is in addition to basic underlying zoning, such as residential or commercial (see Figure 1.5).

   ![Overlaying Zone Diagram]

   a) School, tax, or utility districts
      (1) Taxes are paid to the district by all property owners within the district boundaries
   b) Airport or flight paths

E. Disclosures

1. Brokers and salespeople should explain that it is the ______________________________
   to verify that
   a) the current zoning use and rules will ______________________________.
b) the property is not in a floodplain,

  c) the property has proper access to and from highways and streets, and

  d) building permits were pulled and completed, if required.

VII. AREA (SQUARE FOOTAGE) AND FRONTAGE (STREET FRONT)

A. Area (square footage) and frontage (street front)

  1. Buyers often want to know the square footage of the property or the building.

     a) The rectangle area (square feet) = width × length.

     b) The formula is simply remembered as \( A = W \times L \).

  2. By tradition, the first number of a width-times-length \( (A = W \times L) \) description is the frontage or street front of the property. A lot that is 57 feet by 108 feet has a 57-foot frontage. Conversely, if the property is 90 feet by 48 feet, the frontage is 90 feet.

B. Area calculations

  1. What is the area of a lot 70 feet by 200 feet?

     a) Area of a rectangle = length multiplied by width \( (A = W \times L) \)

     \[
     \begin{align*}
     A & = \text{70 ft} \times \text{200 ft} = \text{14,000} \text{ sq. ft.} \\
     \text{The frontage (street front) is} & \quad \text{70 ft}.
     \end{align*}
     \]

  2. What would this lot sell for at $3 per square foot plus a $5 premium per front foot?

     a) Area: \( A = 70 \text{ ft} \times 200 \text{ ft} = \text{14,000} \text{ sq. ft.} \)

     b) Selling price:

     \[
     \begin{align*}
     \text{14,000 sq. ft.} \times \$3 \text{ per sq. ft.} & = \text{42,000} \text{ plus} \\
     \text{front feet} & \times \$5 = \text{350} \text{ “premium”} \\
     \$42,000 + \$350 & = \text{42,350} \text{ selling price}
     \end{align*}
     \]

C. Determining the price per square foot

  1. Real estate is often sold or valued based on the price per square foot.

     a) Divide either the list or the sales price by the total square feet.

  2. A property listed for $200,000 has 2,000 square feet. What is the price per square foot?

     a) Solution: list price ÷ square feet

     \[
     \begin{align*}
     \$200,000 \div 2,000 & = \text{100 per square foot}
     \end{align*}
     \]
UNIT 1 GLOSSARY REVIEW

1. All property other than real estate is known as ________________________________.
2. Real estate consists of three things: land, improvements, and ________________________________.
3. If a seller is taking a fixture, it must have been ________________________________ from the purchase agreement.
4. Land is not considered a ________________________________ asset because it cannot be sold quickly.
5. When articles of personal property are permanently attached to the improvements, they become ________________________________.
6. Before a new building can be inhabited, a ________________________________ is required.
7. Permission to vary from strict compliance with zoning requirements may be obtained in the form of a ________________________________.
8. When a previously established use does not comply with the requirements of a new zoning ordinance, it may be allowed to continue as a ________________________________.
9. Townships, sections, and meridians are used in the ________________________________ form of legal description.
10. A legal description that uses compass degrees is ________________________________.
11. The type of legal description used in most urban areas is ________________________________.
12. A ________________________________ may be used to separate two incompatible zoning uses.
13. Real estate and fixtures are transferred with a ________________________________.
14. Personal property is transferred with a ________________________________.
15. If the buyer is keeping the seller's personal property, it must be ________________________________ in the purchase agreement.
UNIT 1 QUIZ

1. Section 4 contains how many acres?
   a. 40
   b. 160
   c. 640
   d. 43,560

2. A survey would do all of the following EXCEPT
   a. establish boundaries.
   b. create legal descriptions.
   c. reveal an illegal use such as a commercial use in a residential zone.
   d. find encroachments.

3. Real estate is bought and sold based on
   a. street addresses.
   b. property descriptions.
   c. plat sizes only.
   d. plats and parcels.

4. The definition of real estate includes
   a. land.
   b. improvements.
   c. rights.
   d. all of these.

5. Which of the following would ordinarily be considered personal property?
   a. Drapery rods
   b. Freestanding refrigerator
   c. Built-in bookcase
   d. Ceiling fan

6. All of the following are true about fixtures EXCEPT
   a. fixtures typically start as personal property.
   b. if the seller is going to keep a fixture, it must be excluded in the purchase agreement.
   c. trade fixtures are treated the same as all other fixtures.
   d. the intention, attachment, adaptation, and agreement are all used to define a fixture.

7. A developer bought a 100-acre parcel to subdivide into one-acre homesites. Which of the following methods of legal description would BEST achieve the developer's objectives?
   a. Government survey
   b. Monuments
   c. Lot and block
   d. Metes and bounds

8. Which of the following is generally NOT a use classification established by municipal zoning?
   a. Residential
   b. Mixed
   c. Commercial
   d. Architectural

9. The method of legal description that uses a grid of ranges and tiers is called
   a. government survey.
   b. metes and bounds.
   c. informal reference.
   d. street address.

10. After completing the plat map, the developer's next step is to
    a. request a certificate of occupancy.
    b. pull the building permits.
    c. record the plat map.
    d. sell the lots.

11. Nonconforming use is a term used in reference to property that
    a. extends over lot lines.
    b. is in need of deferred maintenance.
    c. doesn't comply with current zoning requirements but may have been grandfathered in.
    d. has not been recorded.
12. A light industrial plant has been operating in compliance with its zoning classification. After a zoning change to single-family residential use, the owners of the industrial plant are permitted to
   a. convert the building to condominiums.
   b. continue the present use as long as that use is not enlarged or expanded.
   c. build an addition to the plant.
   d. rebuild the plant if it is destroyed by natural causes.

13. At which level are zoning restrictions set?
   a. State
   b. Federal
   c. Local and state
   d. Local

14. Municipalities require submission of blueprints and construction plans before issuing a building permit in order to
   a. provide evidence of compliance with building codes and other local regulations.
   b. prevent unfair competition.
   c. maintain a list of active developers.
   d. control the influx of builders from surrounding areas.

15. A municipality has authorized the improvement of a particular property in a manner NOT authorized by the zoning ordinance. This is an example of a
   a. setback restriction.
   b. buffer zone.
   c. specific performance.
   d. variance.

16. Which method of legal description uses plat maps?
   a. Informal description by street address or rural route
   b. Lot and block
   c. Government survey
   d. Metes and bounds

17. A tenant installed shelving as a part of her business. At the conclusion of the lease, the tenant
   a. may remove the shelving only if she reimburses the landlord.
   b. must leave the shelving because it is the landlord's property.
   c. may remove the shelving and is not required to reimburse the landlord.
   d. must leave the shelving but may demand that the landlord reimburse her.

18. An area of land that separates two drastically different land use zones is a
   a. buffer zone.
   b. setback.
   c. nonconforming zone.
   d. variance.

19. The distance that a zoning ordinance requires between a property's boundaries and its improvements is a
   a. buffer zone.
   b. range.
   c. frontage.
   d. setback.

20. A method of property description using monuments, distances, and compass directions is the
   a. lot and block method.
   b. metes-and-bounds method.
   c. rectangular survey method.
   d. maps and plats method.

21. All of the following would be considered fixtures EXCEPT
   a. plumbing.
   b. wiring.
   c. a built-in oven.
   d. draperies.

22. The legal description of land that uses townships and sections is
   a. rectangular survey.
   b. metes and bounds.
   c. lot and block.
   d. township.
23. The principle of the doctrine of prior appropriation determines
   a. which user’s water rights have priority.
   b. who owns the fixtures.
   c. how personal property is distributed.
   d. who has access to water rights.

24. Which of the following concepts would allow an owner to deviate from zoning regulations and run a day care center in her home in a neighborhood that is zoned residential?
   a. setback
   b. nonconforming use
   c. master plan
   d. special use

25. The document that confirms a new building has met all the minimum building standards and is the final regulatory step in the process of offering new construction for sale is called a
   a. building permit.
   b. certificate of zoning.
   c. building code.
   d. certificate of occupancy.

26. A buyer wants to use a residential property for a small business. Before closing, the buyer should
   a. apply for a special use permit.
   b. check the zoning to determine whether the use is allowed.
   c. call an attorney to request a variance.
   d. apply for a sales tax license.

27. Which of the following BEST defines a plat?
   a. a method of legal description using sections, townships, and ranges
   b. an informal reference to properties in a neighborhood
   c. a document used to record a subdivision of land
   d. an instrument used by surveyors to locate property boundaries

28. Which of the following is TRUE about mineral rights?
   a. They represent an interest in personal property.
   b. They often are held by a third party.
   c. They belong to the state.
   d. Solid mineral rights are an interest in real estate and liquid minerals are considered personal property.

29. A fixture is defined as
   a. personal property attached to real property.
   b. a lien of record.
   c. chattel.
   d. an encumbrance.

30. The seller and the buyer have negotiated an offer back and forth. In the original offer, the buyer asked for the seller’s installed hot tub, which the seller had excluded from all marketing, the MLS listing, and the listing contract. In the final accepted offer, the hot tub is not mentioned. Who will own the hot tub at closing?
   a. The seller, because the seller gave notice in the marketing and MLS listing and the listing broker was aware of the exclusion
   b. The buyer, because the hot tub is automatically transferred with the property because it is personal property
   c. The buyer; the seller would be in breach if the hot tub were to be removed
   d. The seller, because it was excluded in the listing
UNIT 1 QUIZ ANSWERS

1. c   A section contains 640 acres.
2. c   A survey would not find an illegal use.
3. b   Real estate is bought and sold based on property descriptions (also called legal descriptions).
4. d   Real estate includes land, improvements, and rights.
5. b   Personal property is not permanently attached to real estate.
6. c   Trade fixtures are personal property and transfer with a bill of sale.
7. c   A subdivided (recorded) plat is the simplest way to divide a large parcel into smaller lots.
8. d   The most common zoning classifications are residential, commercial, industrial/manufacturing, agricultural, and mixed use.
9. a   The government survey (rectangular survey) established sections, townships, and ranges in the western United States.
10. c   After receiving the plat map, the second step is to record the map. Then the lots can be sold and building permits pulled.
11. c   When zoning in an area changes, a pre-existing improvement is allowed to continue as a nonconforming use.
12. b   When a previously established use does not comply with the requirements of a new zoning ordinance, it may be allowed to continue only if the established use is not enlarged or expanded. Also, the use may not be resumed after it has been discontinued.
13. d   Zoning laws are set at the local level.
14. a   Building permits are required to ensure compliance with building codes and other local regulations.
15. d   Permission to vary or deviate from a zoning restriction comes in the form of a variance. Typically, the type of variance in this case would be a conditional use or special use permit.
16. b   The lot and block (recorded plat) method of description uses plat maps to show the location and boundaries of individual lots in a land subdivision.
17. c   Shelving is an example of a trade fixture. Trade fixtures are the tenant’s personal property and may be removed by the tenant at the conclusion of the lease.
18. a   When adjoining or nearby properties are zoned for drastically different uses, municipalities often create a buffer zone to separate them.
19. d   The setback establishes the minimum distance between the boundaries and the improvements located on the property.
20. b   The metes-and-bounds method of legal description uses distance and direction measurements to describe the boundaries of a property.
21. d   Draperies are considered personal property because they are not attached.
22. a   The rectangular survey uses townships and sections to describe land.
23. a   The doctrine of prior appropriation determines which user’s water rights have priority.
24. d   Special use is the type of variance that allows for different uses of property.
25. d   A certificate of occupancy is the final step to show that a new building meets minimum building standards.
26. b   The buyer is expected to verify that the zoning of the property will meet the intended use.
27. c   A plat is a map showing the location and boundaries in subdivision.
28. b   In a sale, if the seller retains the mineral rights and sells them separately from the surface rights, the new buyer who now holds the sub-surface mineral rights is called the third party.
29. a   Fixtures are personal property that are attached to improvements.
30. c   The hot tub is a fixture and cannot be removed without the seller being in breach because the seller did not specifically exclude it in the purchase agreement.
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- list the four governmental rights in land,
- demonstrate how to use a circle formula to complete math problems,
- differentiate between freehold and leasehold estates and how they affect the transfer of title, and
- explain how the different types of encumbrances affect the use of property.

Study Plan

Before Class:
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.
Read the Unit 2 Key Points.

After Class:
Complete the Glossary Review.
Complete the Review Exam.
An individual’s property rights are subordinate to governmental rights. The government has the power to determine land use, tax, and regulate private property, and even take private property for public use. Police power is the power that implements public controls for land use. It allows state and local governments to regulate how a property owner uses the property (e.g., through zoning laws or other land use restrictions such as environmental limitations), for the protection of the public health, safety, and general welfare. The power of eminent domain is the government’s power to take private property for public use. Condemnation is the process that exercises this right. When private property is taken, the government must pay just compensation to the owner.

General real property taxes are called ad valorem taxes because the amount of the tax is based on the value of the property. General real property taxes are levied to support the general operation and services of government and create a priority lien. Special assessments are levied for the cost of specific local improvements, and only those pieces of property that benefit from the improvement are taxed. A property owner may appeal a tax assessment to the assessment appeals board. If property is abandoned, or if a person dies intestate and without heirs, the property will escheat to the state (the memory aid is PETE).

An estate is an interest in property. There are two types of estates: freehold estates, which are estates of ownership, and leasehold estates, which are estates of possession. Freehold estates have an indefinite duration, while a leasehold estate may be terminated. The three freehold estates are fee simple absolute, fee simple defeasible/determinable (also called a qualified fee because there are deed conditions), and a life estate.

The fee simple absolute estate is the greatest, most complete form of ownership. Fee simple defeasible ownership (also called determinable) is a qualified fee because this type of estate always has a condition that must be met. If the deed condition is broken, the estate may revert to the grantor or the grantor’s heirs. A life estate is an estate measured by someone’s lifetime. The person who will receive the property when the life estate ends holds a reversionary or remainder interest. If no remainderman is named, the estate reverts to the grantor or grantor’s heirs.

A leasehold is an estate of possession and is a non-ownership interest in property. The lessor (landlord) accepts rent from the lessee (tenant) in exchange for possession. There are four types of leasehold estates: the estate for years, the estate from period to period, the estate at will, and the estate at sufferance.

An encumbrance is any right, claim, or interest in property held by someone other than the property owner or the one who has a legal right of possession. An easement is a right of use. Easements may be appurtenant or in gross. Easements may be created by express agreement, necessity, or prescription. Once given, easements are not revocable.

Deed restrictions are privately created limitations on land use. They apply to present and future owners. The most common examples are restrictive covenants imposed on all lots within a subdivision by the original developer. A lien is a financial encumbrance against property. Liens may be specific or general. Specific liens are liens against a specific property. The most common specific liens are government real property tax liens, mechanics’ liens (construction liens), and mortgages. Judgment liens and IRS liens are general liens against all of a person’s assets.
An encroachment is an unauthorized use of someone else’s property, typically a physical object intruding onto neighboring property. Most encroachments are unintentional. A survey or ILC (improvement location certificate) would reveal an encroachment.

A license is similar to an easement; it grants permission to enter another’s property for a specific purpose. However, unlike an easement, a license does not create an interest in the property and is not an encumbrance against the title. Unlike an easement, a license can be revoked at any time.
I. GOVERNMENTAL RIGHTS IN LAND

A. Police power—______________________________ of land
   1. Right to enact and enforce laws governing ____________________________
   2. Planning, ____________________________, building codes
   3. Determines how land can be ____________________________

B. Eminent domain
   1. Right to “take” ____________________________ for public use
   2. Process is called ____________________________
   3. An example of involuntary alienation
   4. Compensation (value plus “damages”)

C. Taxation—property taxes and special assessments
   1. Taxes are paid to the county where the property is located and enforced by a foreclosable lien.
   2. Taxes have priority over ____________________________
   3. Real property taxes are ____________________________ (at assessed value).
      a) Assessed value $\times$ tax rate = property taxes
      b) County assessor determines assessed value, which is used only by the assessor
      c) Appeals of assessment are first made to a ____________________________
   4. ____________________________ are charges against specific properties that benefit from a public improvement.
      a) Found by reading an ____________________________
      b) Often charged on a front footage (street front) basis
      c) If not paid, can create a specific lien with the right of foreclosure
      d) Has second priority after unpaid property taxes

D. Escheat
   1. Government’s reversionary right when a property is abandoned
   2. Exercised when owner dies intestate (no will) and without heirs

E. Remember the mnemonic device PETE
   1. Police power
   2. Eminent domain
   3. Taxation
   4. Escheat
II. INTRODUCTION TO CIRCLE FORMULAS

A. Using circle formulas

1. Many multiplication formulas are written in a straight line, such as $A \times B = C$.
2. A circle formula is another simple way to remember math (see Figure 2.1).

3. The math is the same for all circle formulas.
4. The formula works like a three-legged stool. Cover the portion that needs to be solved and the solution can be found in the other two portions (see Figure 2.2).

B. Real property tax calculations

1. Annual tax = assessed value $\times$ tax rate
2. Assessed value = actual value $\times$ assessment rate
   a) Example: Properties are assessed for tax purposes at 75% of their market value.
      (1) Market value $\times$ 75% = assessed value
      (2) $100,000 \times 75\% = $75,000 assessed value
3. Tax rate
   a) The tax rate can be expressed as part per 100 (percentage) or part per 1,000 (mill rate).
   b) If the rate is $50 per 1,000, divide 50 by 1,000 to get the rate as a decimal (0.050).

4. Examples
   a) What is the assessed value of a property with an actual value of $425,000 when the state sets the assessment rate at 29%?
      (1) Assessed value = $425,000 × 29% (0.29)
      (2) Assessed value =
   b) What is the annual tax on the property if the assessed value is $123,250 with a tax rate of $50 per 1,000 (0.050)?
      (1) Step 1: Assessed value = $123,250
      (2) Step 2: Rate = $50 ÷ 1,000 = 0.050
      (3) Step 3: Assessed value × tax rate = tax
         $123,250 × 0.050 = 

III. OR’S AND EE’S TABLE

<table>
<thead>
<tr>
<th>Document</th>
<th>OR’s Give</th>
<th>EE’s Receive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deed</td>
<td>Grant</td>
<td>Grant</td>
</tr>
<tr>
<td>Lease</td>
<td>Less</td>
<td>Less</td>
</tr>
<tr>
<td>Mortgage</td>
<td>Mortg (borrower)</td>
<td>Mortg (lender)</td>
</tr>
</tbody>
</table>

IV. ESTATES IN LAND

A. Estates
   1. The ________________________________ interest in, or right in, real property that allows or will allow possession
   2. Two types
      a) Freehold estates: ________________________________ duration
      b) Leasehold (nonfreehold): ________________________________

Types of Estates

- Freehold (Ownership)
  - Fee Simple Absolute
  - Fee Simple Deferable/Qualified Fee
  - Life Estate
- Leasehold (Possession)
  - Estate For Years
  - Periodic Tenancy
  - Estate At Will
  - Estate at Sufferance
B. Rights of ownership: freehold estates

Not a big house on a large lot

1. Fee simple absolute—complete bundle of rights (also known as fee estate or fee simple)
   a) Control of property
   b) Lasts
   c) Transferable (alienation) and inheritable

2. Fee simple defeasible (defeated)—or
   a) Created by a deed condition and is
   b) If the is violated, may revert to grantor
   c) Transferable and inheritable

3. Life estate
   a) Life tenant (grantee) is the owner.
   b) Life estate may be measured by life of grantee or by another life (pur autre vie).
   c) Upon death of the life tenant, the estate returns to and goes to the party named in the deed, either
      (1) the grantor—
      (2) a third party—
   d) Life tenant may sell or lease the property, but upon the life tenant's death (or the death of whoever is the measuring life), the buyers/lessees lose their interest.
   e) A life estate is transferable but generally not inheritable.

C. Rights of possession: leasehold estates

1. Key points of leasehold estates
   a) The is for a fixed term.
   b) The tenant/lessee holds a leasehold estate.
   c) The landlord/lessor holds a leased fee estate and has a reversionary interest.
   d) The purchaser of leased property obtains ownership “subject to” the lease.
   e) Amount of notice needed to terminate is set by the lease or state law.
   f) Upon termination, the right of possession reverts to the landlord.

2. Estate (tenancy) for years
   a) required
   b) Death of landlord or tenant terminate
   c) Sale of property does not terminate
3. Periodic estate (tenancy)/estate from period-to-period
   a) _______________________________ for set period upon payment of rent
      (1) Example: month-to-month
      (2) Terminated by advance notice of either party

4. Estate (tenancy) at will
   a) Indefinite duration—tenant occupies at landlord’s discretion
      (1) No fixed term
   b) Terminated by notice, death, or sale of the property

5. Estate (tenancy) at sufferance
   a) Holdover after legal tenancy expires (lowest estate)
   b) Owner may evict tenant or accept rent
      (1) If rent is accepted from tenant at sufferance, estate at sufferance becomes a periodic estate

V. ENCUMBRANCES

A. Key points
   1. An encumbrance is any claim, right, or interest held by a party who is
      _______________________________ of the property; a nonpossessionary interest.
   2. An encumbrance is an imperfection that typically does not add to the value, but it may impact it.
   3. An encumbrance may be created by the property owner and can cloud the title.
   4. _______________________________ if they have any concerns about an encumbrance, such as an easement, lien, deed restriction, or encroachment.

B. Definition of an easement
   1. The _______________________________ of another for a specific purpose
   2. Attaches to and run with the land—transfers with the deed

C. Types of easements
   1. Appurtenant easement has a _______________________________ tenement and a _______________________________ tenement.
      a) _______________________________
b) Does not increase dominant estate’s size, but may increase its value
   (1) Examples:
   (a) Driveway for ingress and egress
   (b) Condominium shared party wall

c) Could grant permanent access to a neighbor’s property

2. Easement has no dominant property, only servient property.
   a) Commercial easement held by company, government, or person
   b) Example: Commercial easement

3. Easement is granted by the courts to a property owner to prevent creation of landlocked property; it is only granted if there is no other access. This easement is only available to private owners and not public utilities, railroads, or governments.

4. Easements may be created by express agreement, prescription, or necessity.
   a) Express written agreement—easement is a real property interest and is therefore transferred by a deed
   b) Not once given
   c) May or may not be paid for

5. Easements can be terminated three ways.
   a) Merger—holder of dominant interest acquires the servient property or vice versa
   b) Release—holder of dominant interest releases rights to servient owner (via quitclaim deed)
      (1) Unless the easement is released, with the
   c) Abandonment—not automatic; must be proved in court

D. Deed restrictions (private controls on real property)

1. Deed restrictions are created controls on land use that protect property values and the interests of property owners.

2. The grantor/owner (usually a developer) imposes limitations on land use for a subdivision.
   a) Examples: No RVs allowed in driveways, no fences in front yard, houses must be a certain square footage, brick siding required

3. Deed restrictions are binding on all present and future owners, and they run with the land (appurtenant).

4. Owners may be subject to injunction or monetary damages for violating covenants.

5. Deed restrictions must be for (e.g., cannot restrict property owners based on race or other protected groups).

6. The strictest rule, zoning, or deed restriction will prevail if there are multiple rules.
E. Liens

1. A claim on land to secure payment of a debt
   a) Allows creditor to take and sell the property if not paid

2. Lien classifications: voluntary versus involuntary, specific versus general

3. Release of liens
   a) A lien releases an unrecorded lien.
   b) A recording of a releases a recorded lien.

F. Lien types

1. Specific liens—attach only to specific real or personal property
   a) Government lien for property taxes or special assessments (involuntary)
      (1) Has over all other liens
   b) Mechanic’s or construction lien (involuntary)—for labor, skill materials, or equipment provided for the improvement of real estate
      (1) This lien can be placed by contractors, workers, or suppliers of materials.
      (2) Lien priority dates back to when work was begun or materials delivered.

2. Mortgage liens or deeds of trust (voluntary)
   a) Voluntary pledge of lands to secure

3. General liens—attach to, including personal and real property
   a) Judgment lien (involuntary)
      (1) Court-ordered claim against an individual and all that the individual owns
      (2) Examples: Unpaid hospital bills, child support

4. IRS or state liens for income taxes (involuntary)

G. Homestead rights

1. A homestead exemption is created by state statute to
   a) Protects against judgments and debits for personal loans and credit cards
   b) Typically does not protect against mortgage liens, property tax liens, or mechanics’ liens that are attached to the real property

2. All states differ in the value of homestead rights and who may receive them.
H. Encroachments

1. An encroachment is the unauthorized use of another person’s land or a physical object intruding onto neighboring property.
   a) Examples: Part of a building or fence exceeds the property line

2. Any buyer who finds an encroachment ____________________________ should consult an attorney.

3. A survey will reveal encroachments.

VI. LICENSES

A. Key point

1. ____________________________, unassignable permission that grants privilege to use the property
   a) Example: A property owner grants his neighbor the right to fish in his farm pond, but decides after a month that he no longer wants him on the property. The owner can revoke the neighbor’s right to fish.
UNIT 2 GLOSSARY REVIEW

appurtenant
deed restrictions
definite duration
easement
easement in gross
eminent domain
encroachment
encumbrance
escheat
fee simple absolute
government lien
indefinite duration
judgment lien
leasehold estate
lien
life estate
local level
mechanic’s lien
police power
private control
property tax lien
revocable
statute of limitations
zoning ordinances

1. List two ways the government can acquire privately held land:
   ■
   ■

2. Public control of land use by the government is known as ________________________.

3. A right of use or enjoyment which one person has in the lands of another for a specific purpose is an ________________________.

4. A tenant’s right to possess real estate for the term of a lease is a ________________________.

5. A tree limb that overhangs into a neighbor's yard is an example of an ________________________.

6. An easement is not ________________________, but a license is.

7. A claim that one person has against the land of another to secure payment of a debt is a ________________________.

8. A person who has not been paid for work performed on real property may record a ________________________.

9. A party wall or a shared driveway is an example of an easement ________________________.

10. The right of an owner to occupy a parcel of real estate forever is a ________________________.

11. The type of lien that takes priority over all others is the ________________________ for property taxes.

12. As part of their right to govern land use, local municipalities enact and enforce ________________________.

13. A freehold estate is an estate of ownership with a(n) ________________________.

14. Leasehold estates are estates of possession with a(n) ________________________.

15. Zoning laws are set at a ________________________.

16. Deed restrictions are created as a form of ________________________ over land use.
UNIT 2 QUIZ

1. Real property taxes are computed based on the property’s
   a. subjective value.
   b. market value.
   c. assessed value.
   d. income value.

2. The process by which the government exercises its power to take private lands for public use is
   a. condemnation.
   b. escheat.
   c. foreclosure.
   d. eminent domain.

3. All of the following are governmental powers EXCEPT
   a. deed restrictions.
   b. taxation.
   c. zoning.
   d. escheat.

4. Under police power, building codes would determine all of the following EXCEPT
   a. acceptable land uses.
   b. the types of plumbing and electrical materials allowed.
   c. height and structure requirements.
   d. methods of construction to be used.

5. The term estate refers to
   a. the amount of property owned by an individual.
   b. the rights held by someone who has a possessory interest in real estate.
   c. a claim against or interest in land held by someone other than the owner of the property.
   d. an exercise of police power.

6. When an individual or entity holds a claim against another’s property, it is
   a. an estate.
   b. a life tenancy.
   c. a lien.
   d. a license.

7. All of the following are considered real property rights EXCEPT
   a. land rights.
   b. governmental rights.
   c. deed rights.
   d. ownership rights.

8. Which of the following would be used by a purchaser to reveal encroachments?
   a. Standard title insurance
   b. Abstract of title
   c. Survey
   d. Attorney’s title opinion

9. Which of the following liens has first priority?
   a. Mechanic’s lien
   b. First mortgage
   c. Property taxes
   d. Court judgment

10. The grantor of a life estate may retain
    a. a leasehold estate.
    b. a qualified fee estate.
    c. rights of remainder.
    d. a reversionary interest.

11. If Ann grants a life estate to Ben and specifies that title will be transferred to Carl upon the death of Ben, which of the following is FALSE?
    a. Ben is the life tenant.
    b. Carl has a reversionary interest.
    c. Ben owns the property.
    d. Carl is the remainderman.

12. The holder of a fee estate
    a. has rights of alienation.
    b. can change deed restrictions.
    c. may terminate a servient tenement.
    d. must hold a reversionary interest.

13. A married couple has been granted the right to occupy and use a 10-acre tract of land forever. Which of the following does the couple hold?
    a. Fee simple estate
    b. Estate for years
    c. Life estate
    d. Leasehold estate
14. In most life estates, the life tenant may do all of the following EXCEPT
   a. will the property.
   b. sell the property.
   c. lease the property.
   d. improve the property.

15. All of the following could be encumbrances on real estate EXCEPT
   a. a lien.
   b. an easement.
   c. a restrictive covenant.
   d. a fixture.

16. An estate that lasts only so long as a specified condition is met is known as a
   a. life estate.
   b. qualified fee.
   c. fee simple absolute.
   d. remainder.

17. The right of the government to establish zoning and land use laws is an exercise of which of the following?
   a. Police power
   b. Escheat
   c. Government survey
   d. Eminent domain

18. The grantor of a qualified fee has set the requirement that the property “must be used only as a school”; this requirement is known as a
   a. qualified condition.
   b. remainder interest.
   c. reversionary interest.
   d. deed condition.

19. A leasehold estate with a definite expiration date that does not require notice by either party is
   a. an estate at will.
   b. a fee simple absolute.
   c. an estate at sufferance.
   d. an estate for years.

20. Which governmental right is exercised when the state acquires private property through condemnation and makes a payment of just compensation?
   a. Escheat
   b. Police power
   c. Taxing power
   d. Eminent domain

21. What is the difference between a freehold and a leasehold estate?
   a. Freeholds are estates of possession, and leaseholds are estates of ownership.
   b. Freeholds have an indefinite duration, but leaseholds can terminate.
   c. Freeholds do not need to be in writing, but leaseholds do.
   d. Freeholds must be fee simple, but leaseholds can be a life estate.

22. A holder of a life estate has all of the following interests EXCEPT
   a. title.
   b. ownership.
   c. possession.
   d. remainder.

23. An irrevocable right to use the lands of another is called
   a. escheat.
   b. a license.
   c. an encroachment.
   d. an easement.

24. A holder of a freehold estate has rights of
   a. escheat.
   b. illegal use.
   c. ownership.
   d. domain.

25. Which is NOT an estate of ownership?
   a. Estate for years
   b. Life tenancy
   c. Fee simple
   d. Qualified fee

26. All of the following would be considered to have an interest in land EXCEPT
   a. a farmer who is leasing 20 acres.
   b. the holder of an easement.
   c. a hunter who has been given permission to hunt in a field.
   d. a lender holding a mortgage lien.

27. Which estate usually does NOT terminate upon the death of the holder of the estate?
   a. Life estate
   b. Estate for years
   c. Estate at will
   d. Estate at sufferance
28. The property Sam bought 30 years ago had an appurtenant easement for access. Twenty years ago the county built a new road, and Sam has not used the easement since that time. When Sam sells the property, the easement
a. will automatically return to the servient property owner.
b. will no longer run with the land due to the statute of limitations.
c. must be renewed by rerecording it with the county.
d. remains in place and will transfer with the property.

29. Protection on a primary home against certain creditors is known as
a. specific lien rights.
b. homestead rights.
c. general lien rights.
d. deed restrictions.
### UNIT 2 QUIZ ANSWERS

1. c  Assessed value $\times$ tax rate = property tax.
2. a  The process is condemnation, the power is eminent domain.
3. a  Deed restrictions are private restrictions on the use or sale of a property.
4. a  Building codes determine the types of plumbing and electrical materials allowed. The height and structure requirements and methods of construction to be used are also determined by building codes. Zoning codes determine acceptable land uses.
5. b  An estate in land refers to the collection or bundle of rights held by someone who has a possessory interest in a piece of real estate.
6. c  A lien secures payment of indebtedness.
7. c  Real property rights are those of land, government, and ownership, not deed rights.
8. c  A survey would be used to discover zoning setback violations or encroachments.
9. c  Government liens for property taxes and special assessments always have top priority.
10. d  If the grantor of a life estate retains reversionary rights, ownership in fee simple reverts to the grantor at the end of the life estate.
11. b  A reversionary interest could only be held by Ann, the grantor.
12. a  A fee estate gives the owner the right to sell, will, or give the property away, which is known as alienation.
13. a  The right to occupy and use land forever is a fee simple estate.
14. a  Most life estates terminate upon the death of the life tenant and therefore cannot be willed. (One exception: A life estate pur autre vie, in which the life of someone other than the life tenant is used as the measuring life.)
15. d  A fixture is real estate. Liens, easements, and restrictive covenants are encumbrances.
16. b  A fee simple defeasible estate (also called qualified fee) lasts “so long as” a condition is met.
17. a  Police power is the government’s right to enact and enforce laws to protect the health, safety, morals, and general welfare of the public (including land use laws).
18. d  Deed conditions are used to create the requirements of qualified fee estates.
19. d  An estate for years has a specific termination date.
20. d  Condemnation is the process by which the government exercises its power of eminent domain.
21. b  Freehold estates are of indefinite duration. Leasehold estates will terminate.
22. d  A life tenant owns the property; therefore, the life tenant has title and possession. The remainder estate belongs to the party who will obtain title upon death of the measuring life.
23. d  Easements are nonrevocable rights of use to another’s property.
24. c  Freehold estates are estates of ownership.
25. a  An estate for years is a right of possession, not ownership. Life tenancy, like all other freehold estates, is an estate of ownership.
26. c  Granting permission to use one’s land creates a license, which is not an interest in land.
27. b  An estate for years is a contract and terminates on the date specified in the lease, not upon death of the lessor or lessee.
28. d  Easements can be terminated by release, merger, or abandonment. If an easement is abandoned and the property owner wants to have it returned, typically the servient property must prove abandonment in court.
29. b  Homestead rights protect a primary home from foreclosure by certain lienholders.
Ownership and Title Transfer

**LEARNING OBJECTIVES** When you have completed this unit, you will be able to

- **describe** the various forms of ownership in real estate and explain how they differ;
- **list** of the types of deeds and explain how they convey ownership;
- **define** and explain testate, intestate, and the probate process;
- **describe** the circumstances and conditions that may provide for the involuntary transfer of title; and
- **explain** the role of property transfer disclosures and the importance of disclosing material facts.

**Study Plan**

**Before Class:**
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.

Read the Unit 3 Key Points.

**After Class:**
Complete the Glossary Review.
Complete the Review Exam.
KEY POINTS—UNIT 3

- When title to real property is held by one person or entity, it is called ownership in severalty. Property may be owned solely by one individual or by a single entity (a corporation, partnership, limited liability company, or real estate investment trust).
- Concurrent ownership or co-ownership exists when two or more people simultaneously share ownership of one piece of property. The two most common forms of co-ownership are tenancy in common and joint tenancy.
- In many states, unless an agreement exists to the contrary, co-ownership is presumed to be a tenancy in common. With a tenancy in common, there is an equal right of possession, but each tenant may hold unequal shares of ownership and there is no right of survivorship.
- With a joint tenancy, each tenant must have an equal ownership share and equal rights of possession. Joint tenants also have a right of survivorship. This means that when a joint tenant dies, his share of ownership in the property automatically passes to the surviving joint tenant(s).
- Common interest communities include condominiums, town houses, cooperatives, time-shares, and planned communities. Sales of these types of properties are generally regulated under an individual state’s common interest ownership act.
- The owner of a condominium unit owns the unit, plus an undivided interest in the common elements as a tenant in common with the other unit owners.
- A cooperative, by comparison, is a building owned by a corporation. Each resident owns shares of stock in the corporation and has a proprietary lease in the individual unit.
- A deed is the document used to transfer real property. A valid deed must identify the parties, have a competent grantor, contain words of conveyance, contain a legal description of the property, state that consideration was given, be properly executed, and be delivered and accepted. The statute of frauds requires that the deed be in writing.
- The three main types of deeds used are the general warranty deed, special warranty deed, and quitclaim deed.
- A general warranty deed carries five basic covenants: seisin, quiet enjoyment, against encumbrances, further assurance, and warranty forever. This deed provides the greatest protection for a grantee (typically the buyer who is receiving title to real property).
- A special or limited warranty deed warrants title only for the time period the grantor owned the real estate. Unlike a general warranty deed, it does not give any warranties for past or future claims unless the claim is for the period the grantor owned the property.
- A quitclaim deed conveys no warranties of any kind. It simply conveys whatever interest the grantor has when the deed is delivered. A quitclaim deed may be used as a “problem solver” to clear clouds on the title.
- When a person dies, the person’s property may be transferred by the terms of a will or according to the rules of descent, which govern intestate succession.
- Property may also be acquired by adverse possession. The adverse possession must be open, continuous, exclusive, actual, and notorious (hostile) for a period of years that are determined by each state.
I. FORMS OF OWNERSHIP

A. Sole ownership/estate in severalty

1. Ownership by _____________________________ is ownership (estate) in severalty.
2. Upon death, the property goes to the _____________________________.
3. A legal entity can own in severalty.
   a) Two or more people or firms joining together as an entity to own real estate is syndication.
      (1) Examples: corporation, partnership, trust, real estate investment trust (REIT)
   b) In a general partnership, all partners have equal say and liability.
   c) In a limited partnership, the limited partners’ liability is ____________________________ of ownership.
   d) The sale of interests may require a securities license.

B. Concurrent (multiple) ownership

1. Definition
   a) In concurrent (multiple) ownership, two or more persons share ownership with ___________________________. Because their shares or interests are ___________________________ but undivided, they have equal rights of possession.
   b) In this type of ownership, no co-owner has a right to any specific part of the property.
   c) Buyers should obtain an ____________________________ to determine the most appropriate form of co-ownership.

2. Tenancy in common: co-ownership ____________________________ to other owners
   a) Default in most states is tenancy in common with equal shares, unless otherwise specified in deed
      (1) With tenancy in common, ____________________________
   b) No survivorship—interests go to heirs or devisees ____________________________
      (1) Subject to probate
      (2) Each ____________________________ for the property taxes as an individual or a group
   c) Partition lawsuit can divide property among co-owners

3. Joint tenancy: co-ownership ____________________________ to other owners
   a) Must be specified in deed—__________________________
   b) Ownership shares must be equal
c) Upon death, interests go to ________________________________ without going through probate
   (1) ________________________________ a will
   (2) Death certificate and joint tenancy affidavit must be recorded

d) Must have four unities
   (1) Possession, interest, title, and time (__________________)

e) Partition lawsuit can divide property among co-owners

4. Ownership by married couples
   a) Tenancy by the entirety is a special form of ownership available exclusively to married couples in some states.
   b) Community property rights in certain states affect property rights after marriage.
      (1) In some states, property owned jointly by a married couple is distinguished from each spouse’s separate property.
      (2) Generally, any property acquired by either spouse during marriage is considered community property.

C. Common interest community ownership

1. Key points
   a) Condominiums, cooperatives, and other forms of common interest ownership are often regulated under a state’s common interest ownership act.
   b) Generally, a common interest community has the authority to levy ________________________________ on its owners for the maintenance of common elements, typically through homeowners association (HOA) dues.
   c) Sellers have disclosure requirements to buyers related to the sale of common interest property.

2. Condominium
   a) Real estate, portions of which are designated for separate ownership (units) and the remainder of which are designated for common ownership and use (______________________________)
   b) May be any type or use of real estate (i.e., residential, commercial)
   c) Created by recording a ________________________________, which describes the legal and physical structure along with any restrictions on use
      (1) Will describe any party walls—shared walls that separate ownership interests such as condominium units
      (2) Specification of common and “limited common elements”
         (a) Common elements are those areas used by all owners, such as a swimming pool, tennis court, hallways, and elevators.
(b) Common elements are owned by all unit owners as

(c) A limited common element is any common element reserved for the use of one or more unit(s) to the exclusion of other units (e.g., assigned parking spaces, storage units, and balconies).

d) Each unit owner is a ___________________________ of the homeowners association, a ___________________________ with the following functions:

(1) Manages common elements and pays any taxes the HOA may owe

(2) Adopts rules, regulations, and budgets

(3) Adopts and amends bylaws

(4) Imposes and collects assessments (association fees), which creates a foreclosable lien on the unit

   (a) Unpaid dues create a specific lien, which can be foreclosed on by the HOA

(5) Holds annual meeting

(6) Maintains insurance on common elements (contents of units are not covered)

e) Separate title and taxation

(1) Deed transfers fee simple interest in unit plus undivided interest in common elements; all unit owners share ownership of common elements as tenants in common

(2) Unit together with common element percentage is a separate parcel

(3) Taxed as one parcel; HOA may also have tax liabilities

f) Owners ___________________________ their individual units independently

g) Sellers required to give buyers full disclosure, including the declaration, bylaws, financial reports, and so on

3. Town house

   a) Similar to condominiums in unit ownership and establishment of the HOA

   b) Generally includes the land under and around the unit

4. Cooperative

   a) Owned by a corporation, which in turn allows owners (stockholders) occupancy

   b) Cooperative corporation (tenants' association) owns the real estate

   c) Buyer receives membership in association, shares of stock, and proprietary lease

   (1) ___________________________

   d) Stockholder/tenant pays assessments and association fees
5. **Time-share**
   a) Purchaser buys interest in real estate and receives right to use property for certain periods of time
   b) Purchasers may own land, or developer may own land and contract for its use
   c) Purchasers of units own as tenants in common with other purchasers
   d) Most common for __________________________
   e) Sale of a time-share or condominium with a mandatory rental pool agreement may require a securities license

**II. CONVEYING OWNERSHIP**

**A. Act of conveying real estate ownership (title): __________________________**

1. A __________________________ is from individuals, using a deed.
2. A __________________________ is from the government to individuals, using a land patent.
3. A __________________________ is from individuals to the government.

**B. Key points and characteristics of deeds**

1. The purpose of a deed is the voluntary transfer of title between the owner/grantor and the receiver/grantee.
2. A seller of real property will always be required to provide __________________________.
3. Every deed conveys whatever interest is held by the grantor, unless it specifically states that it is conveying a lesser interest.
4. The major difference between types of deeds lies in the extent of the promises given by the grantor to the grantee.
5. Deeds do not __________________________.
6. Deeds do not have to be recorded for title to transfer; title passes upon acceptance of the grantee.

**C. Essential elements of a valid deed**

1. Competent grantor
   a) __________________________
   b) Seller is __________________________ and buyer is __________________________
2. Execution by the grantor(s)
   a) Deed must be signed by all owners to convey entire property
3. Identifiable grantee (need not be competent)
4. Delivery to and acceptance by the grantee(s)
   a) Title passes upon __________________________
5. Legal description of the land (property description)
   a) Legal descriptions
      appurtenances are presumed to transfer with the land unless specifically excluded and are not
      mentioned in the legal description

6. Consideration
   a) Money or ________________________________
   b) “One dollar and other good and valuable consideration”

7. Words of conveyance (granting clause)
   a) States that seller is making a grant that conveys the warranties of the deed
      (1) For example: Creates the difference between a general warranty and a quitclaim deed
   b) Habendum clause conveys the freehold estate
      (1) For example: “To have and hold forever” conveys fee simple absolute ownership

**FIGURE 3.1**

**Seven Essential Elements of a Deed**

1. Competent grantor
2. Execution by grantor
3. Identifiable grantee
4. Delivery and acceptance (by grantee)
5. Legal description
6. Consideration
7. Words of conveyance

**D. Types of deeds**

1. General warranty deed
   a) Includes the ________________________________
   b) Greatest protection for the ________________________________
   c) Contains five covenants and warranties of title
      (1) Covenant of ________________________________: grantor owns and has right to convey
      (2) Covenant of ________________________________: grantee will not be “disturbed” by others claiming an interest
      (3) Covenant against encumbrances: no unspecified encumbrances
      (4) Covenant of further assurance: cooperation in signing additional documents
      (5) ________________________________: guarantee of defense of title against claims such as liens or easements

2. Special (limited) warranty deed
   a) Only warrants against ________________________________
      grantor’s ownership
   b) No protection against ________________________________
3. 
   a) Best for the ________________
   b) No covenants or warranties—“______________________________”
   c) Used to clear clouds on title (problem solver)
   d) Would use when grantor wants no future claims or ________________

4. Other deeds
   a) A bargain and sale deed does not warrant against liens or encumbrances but warrants the grantor’s right to convey title.
   b) A trustee’s deed/sheriff’s deed/certificate of sale transfers title at the end of a foreclosure proceeding or statutory redemption period.
   c) A reconveyance deed is used when the borrower pays off a loan secured by a deed of trust.

III. CONVEYANCE AFTER DEATH

A. Probate
   1. Probate is the process of distributing all of a deceased person’s assets.
   2. ________________ in order for the devisee to receive real property.

B. Transfer by will (testate)
   1. Devise is the act of transferring a deceased person’s interest in real estate to another ________________.
   2. Bequest is the act of transferring a deceased person’s interest in personal property to another ________________.

C. Intestate succession (no will)
   1. Heirs/descendants are determined by state laws of descent.

IV. OTHER WAYS OF ACQUIRING RIGHTS (INVOLUNTARY ALIENATION)

A. Key points
   1. The law presumes that owners of real property will ________________ their property and protect their interest by giving a notice to cease and desist to anyone who is trespassing.
   2. Owners who do not inspect their property, even if they live out of town, may lose their rights of ownership if another party possesses or uses the property for a statutory period of time.
      a) Title obtained for possession or an easement by prescription is not voluntarily granted by the property owner but is granted through a court procedure.
   3. Owners who are aware of possession and use by another and have given the possessing/using party ________________ or license to possess or use do not fall under this law.
      a) If all parties know and agree to the possession or use, it cannot be adverse possession or a prescriptive easement because notorious and hostile implies that it is without permission.
B. Adverse possession

1. Ownership recognized by the courts after open, exclusive, actual, and notorious (hostile) of another’s land for a certain period set by state law

C. Easement by prescription/prescriptive easement

1. Easement recognized by the courts after open, continuous, exclusive, actual, and notorious (hostile) of another’s land for a certain period set by state law

   a) Remember the mnemonic device: possession or use must be Open (visible), Continuous, Exclusive (distinct), Actual, and Notorious (hostile)

V. PROPERTY TRANSFER DISCLOSURES

A. Seller’s disclosure statement

1. Most states have an option for a seller’s property disclosure.

   a) The disclosure may be a required form or a written list. The disclosure typically covers the following:

      (1) Land/soil and environmental conditions

      (2) Structural issues and condition of fixtures

      (3) Lot size, encroachments, easements, and so on

      (4) All material defects

   b) Sellers (never the broker) complete the disclosure to the best of their knowledge.

   c) The seller and the broker must disclose visible and latent material defects (facts) to all buyers.

      (1) A material fact or defect is one that, if known,

      (2) A latent defect is a that is not easily discovered by an inspection.

   d) State laws determine when the buyer should receive the disclosure, but it is typically prior to making an offer.

   e) Buyers may be able to rescind the contract if they can prove the seller or the broker knew about a material defect but did not disclose it.

2. Most states require brokers to visually inspect the property. Listing brokers must do the following:

   a) Disclose all material defects they find, even if the seller is not aware of the defect

   b) Request that the seller disclose any latent defects
c) Upon discovery of a material defect, immediately disclose it to all parties to the transaction or potential transaction

(1) Example: A buyer’s broker notices watermarks on the ceiling while showing a property. The broker should disclose the potential roof leak to the buyer and make sure the seller and the listing agent are also notified.

d) Recommend that buyers have a property inspection

3. Broker responsibility for seller misrepresentation: If a seller misrepresents a latent defect in the seller’s property disclosure and the broker performed a visual inspection and did not find any obvious defects in the property, the seller (not the broker) would be held responsible for the misrepresentation.
UNIT 3 GLOSSARY REVIEW

(Some words may be used twice.)

cooperative  grantor  seisin
determination  grantor and grantee  severalty
deed  joint tenancy  sheriff's deed
delivered and accepted  proprietary lease  special warranty deed
delivered and recorded  quiet enjoyment  tenants in common
general warranty deed  quitclaim deed  time-share
grantee

1. A written legal document by which ownership of real property is transferred from one party to another is a __________.
2. The two parties to a deed are the ____________________ and ____________________.
3. In order to convey title, a deed must be signed by the ____________________.
4. Title does not pass to the grantee until the deed is ____________________.
5. Assurance to grantees that they will not be disturbed by someone else with a lawful interest in the property is the covenant of ____________________.
6. The type of deed that is considered the best deed for a grantee is a ____________________.
7. A deed that conveys whatever interest in the property the grantor holds at the time of conveyance and contains no covenants or warranties is a ____________________.
8. A deed with warranties that apply only to the period the grantor owned the property is a ____________________.
9. Property owned by one person is said to be owned in ____________________.
10. A form of concurrent ownership in which each tenant owns an undivided ownership share in the entire property and has no right of survivorship is ____________________.
11. A form of concurrent ownership in which all owners have equal shares in the property and the right of survivorship is ____________________.
12. An undivided interest in a resort condominium as a tenant in common for a specific period each year is a ____________________.
13. A condominium is created by filing a ____________________.
14. ____________________ does not require co-owners to go through probate to obtain title.
15. A person who holds stock in a building owned by a corporation owns the rights to a ____________________.
UNIT 3 QUIZ

1. In a quitclaim deed, the grantor covenants
   a. that the title is marketable.
   b. nothing.
   c. that she owns the property and has the right to convey title.
   d. that she will defend any claims against the title.

2. To be valid, a deed must have a
   a. property description.
   b. list of encumbrances.
   c. competent grantee.
   d. description of all improvements.

3. In regard to a deed, the term execution refers to
   a. notarization.
   b. recordation.
   c. delivery and acceptance.
   d. the signature(s) of the grantor(s).

4. The covenant affirming that the grantor holds title and has the right to convey it to another is the covenant
   a. of further assurance.
   b. against encumbrances.
   c. of quiet enjoyment.
   d. of seisin.

5. If a lender wanted to convey title on a foreclosed property with no warranties to the grantee and no liabilities to the grantor, it would be logical to use a
   a. quitclaim deed.
   b. special warranty deed.
   c. warranty deed.
   d. sheriff’s deed.

6. The probate process
   a. settles disputes between co-owners of property.
   b. rules on warranty claims.
   c. is required if the party died testate.
   d. determines claims under adverse possession.

7. Which parties must sign a deed to make it valid?
   a. Grantors only
   b. Grantees only
   c. Both grantors and grantees
   d. Lessees only

8. Ownership in severalty refers to
   a. more than one owner.
   b. the right of survivorship.
   c. ownership between a husband and wife.
   d. ownership by one person or entity.

9. Which must always be TRUE of tenants in common?
   a. Each tenant must have an equal ownership share.
   b. Each tenant rents his share of the land.
   c. Each tenant has the right of survivorship.
   d. Each tenant must join in a conveyance of title to the property.

10. A couple wants to buy a house together. If either one should die, they want the deceased’s share to go to that person’s heirs. Which form of ownership allows for this option?
   a. Tenancy in common
   b. Tenancy by the entirety
   c. Joint tenancy
   d. Estate in severalty

11. Which of the following gives the grantee the most protection?
   a. General warranty deed
   b. Limited warranty deed
   c. Quitclaim deed
   d. Bargain and sale deed

12. Which of the following is NOT essential to the validity of a deed?
   a. Recording
   b. Competent grantor
   c. Execution by the grantor
   d. Words of conveyance

13. A couple buys a property together. If one dies, the title will automatically pass to the other owner. How did the couple take title?
   a. Joint tenants
   b. Tenants in severalty
   c. Tenants by the entirety
   d. Tenants in common
14. Donna owned a home in severalty, and she died testate. After her death, her interest in the home transferred to the
   a. remaining owners.
   b. devisee she named in her will.
   c. state in which she died.
   d. executor of her estate.

15. Conveyance of title occurs at the moment the
   a. deed is delivered and accepted.
   b. deed is recorded.
   c. grantor receives the consideration.
   d. deed is signed by the grantor.

16. The developer of a condominium wishes to relocate the boundaries of a condominium unit. The developer should
   a. terminate the property manager’s contract.
   b. terminate the association’s master insurance policy.
   c. file an amendment to the condominium declaration.
   d. foreclose and sell the property at auction.

17. The deed that limits the grantor’s warranties to the grantor’s period of ownership is the
   a. quitclaim deed.
   b. special warranty deed.
   c. general warranty deed.
   d. trustee’s deed.

18. A right acquired by a non-owner through use of the lands of another is an easement
   a. by expression.
   b. appurtenant.
   c. by prescription.
   d. by necessity.

19. A party that takes possession of another’s real property without permission may, in the future, be able to claim
   a. title due to adverse possession.
   b. prescriptive easement rights.
   c. a qualified fee estate.
   d. reversionary rights.

20. All of the following are necessary for a valid deed EXCEPT
   a. the signature of the grantee.
   b. words of conveyance.
   c. a legal description.
   d. the names of the parties.

21. The form of ownership in which each owner owns and finances their individual unit plus owns a share of common elements is called a
   a. condominium.
   b. general partnership.
   c. cooperative.
   d. limited partnership.

22. Which is MOST closely associated with the voluntary alienation of real property?
   a. Bill of sale
   b. Adverse possession
   c. Deed
   d. Easement by necessity

23. In a limited partnership, the limited partner’s liability is
   a. the same as all the other partners.
   b. limited to whatever amount the general partners deem appropriate.
   c. the same as all the other general partners’ liability.
   d. limited to the amount of the limited partner’s investment in the partnership.

24. With tenants in common, the obligation to pay property taxes is
   a. based on the shares of ownership.
   b. shared equally, which is required in this form of ownership.
   c. the obligation of the owner that survives.
   d. the responsibility of each individual owner and the owners as a group.

25. The person who signs the deed and conveys title is called the
   a. trustor.
   b. lessor.
   c. grantee.
   d. grantor.
26. An owner of a ranch has become very reclusive and has not left his home for 30 years. On the far side of the ranch, his neighbor built a barn and corral 25 years ago. In this situation, the neighbor
   a. will lose all the improvements and land if the owner gives notice.
   b. has stolen real property and may go to prison.
   c. may try to claim title through adverse possession and a suit to quiet title.
   d. will have the right to sell the improvements to the ranch owner because no notice was given.

27. The common elements in a condominium are owned by
   a. all the members of the HOA as joint tenants.
   b. all former and current unit owners as tenants in common.
   c. the HOA and current shareholders in severalty.
   d. all current owners as tenants in common.

28. A property was sold by a married couple using a general warranty deed. After closing, the buyer discovered there was a third owner who had not signed the deed. The sellers broke the covenant of
   a. quiet enjoyment.
   b. further assurance.
   c. seisin.
   d. warranty forever.

29. During an inspection of her property, an out-of-town owner noticed that a shed and garden had been built on her property. A neighbor working in the garden told the owner she intends to take title to the property through adverse possession. The owner gave the gardener written permission to continue using her property for the shed and garden. Will the gardener be able to obtain title in the future?
   a. Yes, if the gardener meets the requirements of time for adverse possession.
   b. No, the owner has given notice, so the gardener will have an easement by prescription.
   c. Yes, but since the gardener received notice, there will be additional requirements to take title.
   d. No, the gardener has been given a license and the owner may revoke permission to possess or use the property at any time.

30. A married couple asked a real estate salesperson what would be the best option for them to take title. The salesperson may
   a. recommend joint tenancy, which is the preferred choice for married couples.
   b. explain the choices and recommend joint tenancy.
   c. tell the couple it is their decision because the salesperson cannot recommend anything.
   d. describe the choices and, if the couple is still undecided, recommend they speak to a financial or estate planner.
UNIT 3 QUIZ ANSWERS

1. b There are no covenants (promises) in a quitclaim deed.
2. a Valid deeds must contain a property (or legal) description.
3. d Execution of a document refers to the act of signing it.
4. d The covenant of seisin affirms that the grantor owns and has the right to convey title.
5. a A quitclaim deed conveys whatever title the grantor holds and gives no warranties or covenants, past or future. This deed would allow the bank to have no future title claims or liabilities.
6. c Probate is the process by which a deceased person’s instructions are carried out and is required if the party died testate (with a will).
7. a The grantors sign (execute) the deed.
8. d Severalty refers to sole (severed) ownership.
9. d While shares in a tenancy in common may be unequal, each co-owner must sign the document(s) of title conveyance (e.g., deed, contract for deed).
10. a In a tenancy in common, the deceased person’s interest goes to the decedent’s heirs. There is no right of survivorship.
11. a The general warranty deed, in which the grantor gives five covenants and warranties, offers the grantee the most protection.
12. a Deeds do not need to be recorded to be valid.
13. a Multiple ownership with the right of survivorship to co-owners is joint tenancy.
14. b Sole owners may will their property to others. One who acquires title to real property by will is called a devisee.
15. a Title transfers upon delivery and acceptance of the deed.
16. c The declaration creates the condominium unit boundaries; therefore, the declaration will need to be amended to make any changes.
17. b The covenants in a special (limited) warranty deed relate only to the grantor’s period of ownership.
18. c When one person uses the land of another for a specific purpose, without permission, the user could acquire an easement by prescription.
19. a A party that takes possession of another’s real property without permission actually, openly, continuously, exclusively, notoriously, and in a hostile manner for the minimum statutory period may be able to go to court and claim title to the property.
20. a The deed is signed by the grantor(s) only.
21. a In a condominium, the owner owns and finances an individual unit. In a cooperative, the owner finances the shares of stock that represents ownership in the cooperative and has a proprietary lease providing rights of possession to the unit.
22. c A deed is an example of voluntary alienation, in which the grantor willingly severs ownership to the property and conveys it to another.
23. d A limited partner’s liability is limited to the amount of the limited partner’s investment in the partnership.
24. d The obligation to pay property taxes in tenancy in common is the responsibility of the individual owners and the owners as a group because, from the taxing authority’s point of view, taxes are due for the property as a whole regardless of which owner pays them. If one of the owners fails to pay a portion of the taxes, the government can go after the entire group. The individual owners may then go after each other to recover their fair share of taxes paid.
25. d The grantor is the only party that is required to sign the deed.
26. c If the neighbor has possessed the property for the statutory amount of time required by the state, the neighbor may use a suit to quiet title to try and obtain title to the property.
27. d Common elements are owned by all unit owners as tenants in common.
28. c The sellers broke the covenant of seisin, which states they had full ownership and could convey the property.
29. d Adverse possession cannot take place if the property owner is aware of the possession or use. By giving the gardener permission, the owner gave her a license that can be revoked at any time.
30. c Typically, the broker or the salesperson is allowed to describe each type of tenancy but may not recommend how to take title.
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- summarize how the public recording system works and why it is important for real estate;
- explain how title insurance, an abstract of title, and a suit to quiet title are used to provide marketable title;
- discuss the major environmental issues that pertain to real estate and the disclosure obligations for each of them; and
- explain closing procedures, including the use of an escrow agent and the difference between debits and credits on a closing statement.

Study Plan

Before Class:
Complete the reading assignment in Modern Real Estate Practice listed in the MREP Workbook Reading Guide.
Read the Unit 4 Key Points.

After Class:
Complete the Glossary Review.
Complete the Review Exam.
State laws determine how documents are filed for recording. The recording system provides a way of determining who owns a particular piece of real property. Once a document has been recorded, everyone has constructive notice or legal notice of its contents, by operation of law. Recorded documents are indexed alphabetically according to the names of the grantor and grantee.

In many states, the recording system is known as a race/notice system: the first to record a deed wins, if that person has no notice of prior conveyances. State laws determine how documents are filed for recording.

Marketable title is title that is reasonably free from risk of litigation over possible defects or undisclosed encumbrances.

The most common way for a seller to demonstrate that the title will convey is to pay for and provide title insurance for the buyer.

In a title insurance policy, the title insurance company agrees to reimburse the policyholder for losses caused by defects in the title that were not discovered during title search, and also agrees to handle the legal defense of claims based on covered defects. A title policy may insure the owner (the buyer) and/or lender. The purchase agreement and tradition determine who pays for the title insurance policy.

In some states, an abstract with a title opinion is used. The seller updates the abstract, which is a summary of all conveyances, and delivers it to the buyer. The buyer’s attorney then renders a title opinion, which states the marketability of the title.

To clear away a cloud and establish marketable title, a property owner may have to file a quiet title action.

The Real Estate Settlement Procedures Act (RESPA) regulates lenders and standardizes real estate settlement practices in residential mortgage transactions. The law requires that certain disclosures be made to loan applicants concerning all closing costs the buyer will incur. The lender must provide a good-faith estimate within three days of loan application and provide the HUD-1 settlement statement at closing (one day before closing on request).

Brokers and the licensees who work for them have responsibilities to safeguard the money involved in a transaction. Additionally, a final accounting called a settlement statement is provided at closing to verify that all funds paid in connection with the transaction are correctly transferred.

Federal law requires that the seller or the landlord disclose the possible presence of lead-based paint for any residential property built before 1978 and whenever the owner knows of any lead hazard. Disclosure of other known environmental hazards such as asbestos, radon, formaldehyde, carbon monoxide, and mold is also required.
I. PUBLIC RECORDING SYSTEM

A. Key points

1. Policies and procedures that regulate recording are established by ___________________________. These laws determine who is responsible for organizing and maintaining recorded documents for each state.

2. Recording __________________________ of the document.

B. Recording process used at the recording office

1. Note the date and time the document is filed.
2. Assign a recording number.
3. Copy the document into public record (photocopy or digital image).
4. List the document in grantor and grantee indexes.
5. Return the original document to the indicated party.

C. System allows users to post claims

1. Gives __________________________
2. Establishes __________________________ of interests—“first in time, first in right”
   a) A deed does not have to be recorded to be valid.
   b) A grantee who does not record a deed risks having another party claim title to the property.
3. Creates priority (position) of the documents based on date and time of recordation

D. System allows users to search claims

1. Inspect property for visible claims and __________________________ notice, such as parties in possession or encroachments
2. Inspect public records for __________________________, such as liens and persons on the title
3. Part of buyers’ due diligence is to inspect (or have someone inspect) both the property (e.g. home inspection) and public records (e.g. title search)

E. Requirements for recording

1. Deeds, mortgages and trust deeds, contracts for deed, easements, and long-term leases are among the types of documents that are usually recorded.
2. Recorded documents should be executed (signed).
   a) Most states require documents to be acknowledged (notarized) to be recorded. This confirms that the transfer is voluntary and not under duress.
   b) A deed that is not recorded lacks __________________________ notice of ownership.
3. Recording fee and transfer taxes are determined by state law.
   a) State laws determine if there is a charge for the property transfer (called deed tax, documentary fees, or tax stamp) and who pays for it.
   b) They are typically paid when the deed is recorded and can be paid by either the seller or the buyer.

F. Subordination

1. Subordination is a clause in a mortgage/deed of trust or agreement in which the lender permits a subsequent mortgage to take or ____________________________.
   a) Allows mortgages to maintain their ____________________________

2. If a previous mortgage/deed of trust is refinanced, the secondary mortgage/deed of trust continues its subordinate position.

II. HOW MARKETABLE TITLE IS DETERMINED

A. Key points

1. Marketable (or merchantable) title is ownership free from reasonable doubt. The buyer's goal is to obtain marketable title.

2. To know what makes valid documents, brokers and salespeople need to understand
   a) what makes title marketable,
   b) how ownership issues may impact title transfer,
   c) the essential elements of contracts and deeds, and
   d) who is required to sign each document in the transaction.

B. Title search

1. An examiner reviews public records pertaining to a property.
   a) The examiner may be an attorney or trained title examiner.

2. The search is from the present to the original source of title.
   a) The original source can be a land grant or a U.S. patent.

3. This process is used to establish the chain of title.
   a) The chain of title is a history of successive ____________________________.
   b) The examiner seeks an unbroken chain.

4. If errors or missing documents are found (a broken chain) in a title search, then the title is said to be clouded.
   a) The seller will need to clear the title to convey the property.
b) Small issues such as a non-recorded name change may be corrected with a correction or quitclaim deed.

c) Larger issues may require a suit to quiet title.

5. Many states have a marketable title act that requires title searches to only go back for a certain period of years (e.g., 30 or 60) because it is presumed that defects older than that should be extinguished.

C. Abstract of title and attorney’s opinion of title (see Figure 4.1)

1. This method is used in some states, although title insurance is often preferred.

2. An abstract of title is a comprehensive record of all recorded documents affecting title to a given parcel of land and is created through a title search.

3. The seller is expected to furnish an updated abstract, which shows all recorded interests.

4. The buyer’s attorney examines the abstract to trace the chain of title and determine marketability.

5. After tracing the chain of title, the attorney renders a title opinion.

   a) Shows current status of rights

   b) ______________________________________________________________________

   c) Often called a certificate of title

D. Title insurance

1. Best method for insuring marketable title

2. Title search performed by examiner

3. Title report and commitment

   a) The title report states the comprehensive and is a commitment to insure.

      (1) Shows the comprehensive of recorded encumbrances

      (2) Does not show comprehensive of past owners or encumbrances

   b) The commitment lists policy exceptions, which are defects and encumbrances that have been discovered or may exist, and are comprehensive the policy.

      (1) _____________________________: Items never covered; buyer responsible for checking

      (2) _____________________________: Clouds specific to the property discovered by examiner

   c) The buyer may offer objections prior to closing.
III. TITLE INSURANCE POLICIES

A. Standard coverage policy
   1. A standard coverage policy protects against all problems ________________.
      a) Excludes exceptions found before closing and listed in the title report
   2. It covers matters of record that are not listed as exceptions, including the following:
      a) Errors in the title examination
      b) Errors in the abstract
      c) Errors in the public record, such as misfiled documents
      d) Hidden defects, such as forgery, incompetency, misrepresented marital status, and improperly
         prepared deeds

B. Extended coverage policy
   1. An extended coverage policy protects against the same types of problems as a standard coverage policy.
   2. It also protects against problems that are not a matter of public record, but would probably be
      discovered through inspection of the property, such as the following:
      a) Parties in possession or adverse possession issues
      b) Matters of survey, such as encroachments
      c) Gap period typically from the time the commitment is issued until the deed is recorded

C. Types of policies
   1. New buyers will receive an ______________________, which protects owners/buyers and their heirs while they have an interest.
      a) Coverage cost is based on the sale price of the property
      b) Paid for by the seller or the buyer as per tradition and/or the purchase agreement
      c) Coverage continues until the property changes title
   2. A ______________________ protects the mortgagee/lender.
      a) Coverage is based on the loan amount
      b) Often paid for by the buyer, but the seller could also pay for it
      c) Coverage diminishes with each loan payment and ceases to exist when loan is satisfied

D. Policy premium
   1. Unlike most insurance, the premium for title insurance is ______________________
      when the policy is issued at closing.
IV. SUIT TO QUIET TITLE

A. Key points

1. Court hearing to determine ownership, recognize other valid claims, and “quiet” invalid claims
   a) Used to clear clouded title
   b) Establishes ownership under adverse possession

B. Notice sent to interested parties

1. A ________________ is filed.
   a) Recorded notice of a pending lawsuit affecting title to property

2. All parties with a claim must present evidence of the claim in court.

C. Court hears and judges claims

1. The process recognizes valid claims and “quiets” invalid claims.

2. Once the court order is recorded, the cloud on title is ________________.

V. ENVIRONMENTAL ISSUES—DISCLOSURE REQUIREMENTS VARY BASED ON STATE LAW

A. Key points

1. Most environmental issues fall under the purview of the ____________________________.

2. Real estate professionals should have a working understanding of environmental issues and disclosure obligations. Additionally, they should
   a) be familiar with the environmental issues common to the area in which they practice,
   b) look for signs of contamination and other issues, and
   c) inform and recommend (but never advise) further investigation into the impact of environmental issues.

3. Environmental issues are considered ________________ by sellers and brokers.

4. Brokers who suspect an environmental issue must disclose it, even if the seller believes it has been cured or removed.

5. Brokers should recommend that the buyer have the property inspected to verify if there are any concerns.

6. Properties with a high level of contamination may need to have the hazard removed or cleaned before the sale.

B. Asbestos

1. Asbestos is a mineral used in building that can cause respiratory disease.

2. Asbestos was used before 1978 in a variety of building materials, including pipe and wall insulation, flooring, and siding.
3. It is harmful only if the fibers are friable (broken and potentially airborne). The hazard is from inhaling the microscopic fibers, which can cause a variety of respiratory diseases.

4. If a building is being demolished or renovated, ________________________________ should be done by a licensed professional before demolition.

5. ____________________ (sealing in place) is ________________________________ than removal because there is less of a risk of exposing the fibers.

C. Lead-based paint disclosures

1. Elevated levels of lead can cause serious and potentially fatal neurological damage; children and pregnant women are most at risk.

2. Federal law requires ________________________________ of housing built before ________________________________ to make a disclosure to buyers, even if a real estate licensee is not involved in the transaction. Brokers must inform sellers of their obligation to perform the following:
   a) Disclose the location of any known lead-based paint
   b) Provide a copy of any report on the home
   c) Give a copy of the EPA pamphlet on lead poisoning
   d) Offer buyers a 10-day opportunity to have the home tested
      (1) Buyers may ________________________________
      (2) If not waived, buyers may terminate the contract during the 10-day inspection period
   e) Sellers are not required to do a ________________________________

3. The listing broker is responsible for making sure that the purchase agreement includes signed acknowledgments by the buyers, the sellers, and all real estate professionals.
   a) Real estate brokers must sign the lead-based paint disclosure in the purchase agreement and are responsible for making sure all parties are ________________________________.

4. Property managers and landlords must give a similar disclosure and EPA pamphlet to renters if the property was built before 1978.
   a) The renter does not have to be given the opportunity to test or have lead-based paint removed.

5. The Renovation, Repair, and Painting (RRP) program of 2010 covers firms, trades, and individuals performing renovation, repair, and painting that disturbs lead-based paint.
   a) Must be certified in containment and cleanup of lead dust and debris
   b) Must provide owners with the Renovate Right brochure before starting work
   c) Property owners working on their personal property are exempt, but must be in compliance if working on their rental property
   d) Considered a material fact if the renovation was completed in violation of this rule
D. Radon
1. Radon is a naturally occurring _________________________________.
2. Radon moves from the ground to the atmosphere.
3. Radon creates a hazard if it is trapped in a building. It can cause lung cancer.
4. Radon is relatively easy to test for but is impossible to detect without testing. A professional radon tester can discover the presence of radon and recommend a plan to lower the level of radon in the property (mitigation).
5. Radon is ____________________ by adding a ventilation system to move the gas outside, which is typically less expensive than solutions for many other environmental issues.

E. Carbon monoxide (CO)
1. Carbon monoxide is an odorless gas that is the byproduct of combustion.
2. If combustion appliances, furnaces, and wood stoves are working properly and have proper ventilation, CO is not an issue.
3. Improper ventilation or equipment malfunction can cause a buildup of CO gas, which can lead to death.
4. Carbon monoxide can be detected with a CO monitor/detector.
   a) Many states require properties to have CO detectors.
   b) Home inspectors should test for CO build up, and know the requirements for detectors.

F. Mold
1. Toxic mold is created by excess moisture.
2. Not all molds are hazardous. Mold can grow anywhere there is oxygen, moisture, and an organic food source.
3. If found in housing, mold can be a hazard and may require remediation.
4. ____________________ (removal) of mold should be done per EPA and state regulations.
5. There is no federal disclosure law for mold. Some states, however, have their own disclosure requirements.
6. Buyers may have their inspector check for mold.
7. Sellers must disclose if there was or is a mold issue.
8. Brokers should be aware of indications of mold, such as a musty smell, water damage, high humidity, or water leaks.
9. Mold may not be covered by the homeowners insurance policy.
G. Other environmental issues

1. Formaldehyde, chlorofluorocarbons, electromagnetic fields, and methamphetamine labs all pose potential problems.

2. Brokers and salespeople should also be aware of the impact of underground storage tanks, groundwater pollution, brownfields, and waste disposal sites.

H. Environmental impact statement (EIS)

1. The EIS describes the potential impact of a proposed project on local and regional
   a) air,
   b) wetlands,
   c) land, and
   d) environment.

2. An environmental impact statement is mandatory for government projects and may be required for private development.

I. Stigmatized properties (psychological impact)

1. Stigmatized properties are those that may be deemed undesirable due to activities that occurred there.
   a) Includes issues such as suicide, murder, criminal activity, and HIV or AIDS

2. ________________ if or when these issues may be disclosed.

VI. SETTLEMENT/CLOSING PROCEDURES

A. Real Estate Settlement Procedures Act (RESPA)

1. RESPA standardizes closing practices for one- to four-family residential properties financed by federally related loans.
   a) It includes FHA and VA loans, conventional loans funded by regulated lenders, and loans that will be sold on the secondary mortgage market.

2. RESPA regulates lenders, title companies, and real estate licensees.

3. Lenders must give a __________________________ (including loan origination and discount points) and a Shopping for Your Home Loan settlement costs booklet at the time of loan application or within __________________________ of application.
   a) The good-faith estimate is used at the beginning of the loan process to provide the borrower with an estimate of the total closing costs so the borrower knows what funds to bring to closing.

4. Lenders must provide the HUD-1 Settlement Statement at closing (one day prior to settlement upon request).
   a) The HUD-1 reflects the good-faith estimate; however, it contains the final figures to close the loan.
5. RESPA restricts the amount of advance escrow payments (taxes and insurance) and prohibits kickbacks.
   a) Escrow accounts may not have more than two months of additional fees plus what is owed.
      (1) Example: The current insurance amount owed is six months at $50 per month or $300, so the lender may hold up to $400 in the insurance escrow account.

B. Escrow
   1. Closings in some states are conducted using escrow agents.
   2. Some states have closings across the table with all parties present.
   3. The escrow agent/escrow holder is a disinterested party who assists in carrying out the transaction according to the terms of the _____________________________.
   4. The listing brokerage firm is often responsible for the overall closing; the firm may be assisted by a closing or settlement company.

C. Closing statement
   1. A closing statement is a detailed accounting of each party’s debits and credits (amounts paid and received).
   2. Debit to buyer is anything that increases the amount of money the buyer must bring to the closing.
      a) Examples: ____________________________, new loan origination fees, recording the warranty deed, or discount points if paid by buyer
   3. Credit to buyer is anything that decreases the amount of money the buyer must bring to the closing.
      a) Examples: ____________________________, new loan amount (all loans are always a buyer credit), interest on assumed mortgage or seller financing
   4. Debit to seller is anything that decreases the amount of money the seller takes from the closing.
      a) Examples: ____________________________, owner’s title insurance, payoff of existing loan, or seller financing
   5. Credit to seller is anything that increases the amount of money the seller takes from the closing.
      a) Example: ____________________________

VII. PRORATION (NATIONAL EXAM)

A. Calculating prorations
   1. Certain costs are prorated (divided between the buyer and the seller) as of the date of closing.
      a) These costs include things such as interest on assumed mortgages, rents, utilities, HOA dues, and taxes.
2. If the payment was made in advance, calculate the amount owed on the buyer side of the billing period. If the payment will be made in arrears, calculate the amount owed on the seller side of the billing period.

   a) Remember: The party that writes the big check (actually pays the bill in full) will receive a credit at settlement.

3. The prorated amount will always be ________________________________ with a debit to one party and a credit to the other.

   a) Example: The seller owes property taxes of $50 to the buyer, so debit the seller $50 and credit the buyer $50.

4. Rent will be prorated, but security deposits will not because the full deposit amount transfers to the new owner to hold for the tenant.
5. The proration calculation is always the same: (amount for the billing period ÷ days in the billing period) × days the person owns.

6. On the national portion of the licensing exam, the question may use 360 days per year, 30 days per month, and the seller owns on the day of closing, or the question may use the actual days in a 365-day year.

   a) Always complete the proration using the information given in the exam question.

B. Practice question

1. An investment property is being closed on June 20 with the seller having the day of closing. The water bill for the month paid in advance was $60. How will it be paid at closing?

   a) The buyer owes because the seller paid the bill on June 1 for the entire month. The buyer owes the portion of the month from June 21–30.

   b) To find the days the buyer owes, subtract the total days from the ________________: 30 – 20 = 10 days.

   c) The formula is always the same:

   - (total amount ÷ total days) × days owed = $
   - ($60 ÷ 30) × 10 days = $
   - $2 × 10 days = $20

   Buyer owes seller: debit buyer and credit seller
C. Big side versus little side

1. Some proration questions can be solved without having to do the math by simply looking for the big side versus the little side.

2. In the previous problem, the buyer owed the little side (smaller number of days in the billing period).

3. An investment property is being closed on June 20, with the seller having the day of closing. The water bill for the month paid in advance was $60. How will it be paid at closing?
   a) Debit buyer $40, credit seller $40
   b) Credit seller $20, debit buyer $20
   c) Debit seller $40, credit buyer $40
   d) Credit buyer $20, debit seller $20

   (1) There is no need to do the math because the question states that the buyer owed (debit the buyer) the seller (credit the seller) the small side of the equation.
1. The priority of a recorded instrument is determined by the date of _____________________.
2. When an attorney or title insurance company traces the ownership of a parcel of land to the beginning of its recorded history, the process is known as a _____________________.
3. A recorded notice stating that a pending lawsuit may affect title to a particular property is a _____________________.
4. A document that summarizes all recorded interests affecting title to a given parcel of land is an _____________________.
5. All the documents that comprise the history of the title are the _____________________.
6. Protection against incomplete or defective records of the title to land can best be obtained by securing _____________________.
7. In many cases it is better to ______________________ asbestos rather than to ______________________ it.
8. A problem that is not covered by standard or extended title insurance is an _____________________.
9. When prorating, an item paid in advance will be a ______________________ to the buyer.
10. The federal act that applies to closings and requires a good-faith estimate of costs and a HUD-1 Settlement Statement is _____________________.
11. An item paid in arrears will be a ______________________ to the buyer.
12. Most deeds to be recorded must be ______________________.
13. A new loan will show on the settlement statement as a buyer ______________________.
14. Shared items, such as property taxes and water bills, will be ______________________ between the buyer and the seller.
15. ______________________ is an odorless, colorless gas that, if found, is often mitigated by adding ventilation.
1. A chain of title is
   a. a form of land measurement used by surveyors on plat maps.
   b. a form of title insurance resulting in a strong guarantee.
   c. an encumbrance on title that may prohibit sale of the land.
   d. a property history of successive conveyances and recorded interests.

2. Legal action taken on a title claimant’s behalf to resolve all clouds on title is known as a
   a. suit for damages.
   b. foreclosure suit.
   c. suit to quiet title.
   d. partition suit.

3. Which of the following is TRUE about the recording of documents?
   a. All real estate documents must be recorded to be valid.
   b. Recording real estate documents provides constructive notice of their contents to the public.
   c. Recording real estate documents provides actual notice of their contents to the public.
   d. Recording guarantees a valid and good title.

4. The requirements for recording are determined by
   a. the county clerk.
   b. title insurance companies.
   c. state law.
   d. federal law.

5. A lender making a loan secured by a mortgage will probably require the borrower to buy
   a. a mortgagee’s title insurance policy.
   b. a mortgagor’s title insurance policy.
   c. an owner’s title insurance policy.
   d. mortgage insurance.

6. Standard coverage title insurance protects against all of the following EXCEPT
   a. a forged deed.
   b. encroachments.
   c. errors in the public record.
   d. errors in the abstract.

7. A title search follows documents from the current to the first known source. In doing so, the examiner is following or creating the
   a. title commitment.
   b. title opinion.
   c. owner’s policy.
   d. chain of title.

8. Which of the following would benefit most from, and therefore be most concerned with, recording a mortgage?
   a. Title insurance company
   b. Grantor
   c. Mortgagor
   d. Mortgagee

9. A mortgagee’s title insurance policy protects the
   a. lender.
   b. borrower.
   c. grantor.
   d. grantee.

10. A second mortgage can be distinguished from a first mortgage by the date the mortgage was
    a. acknowledged
    b. given.
    c. recorded.
    d. delivered and accepted.

11. In MOST cases, for a deed to be recorded it must be
    a. acknowledged.
    b. signed by the grantee.
    c. valid.
    d. signed by both the grantor and grantee.

12. A deed that has not been recorded may NOT provide
    a. competent parties.
    b. constructive notice.
    c. actual notice.
    d. a valid document.

13. Title insurance premiums are paid
    a. once, at the time the policy is issued.
    b. monthly, with the mortgage payment.
    c. semiannually, along with the property taxes.
    d. annually, along with the homeowner’s insurance premium.
14. Which of the following would give a buyer the MOST protection against losses resulting from title defects?
   a. Mortgage default insurance
   b. Owner's title insurance policy
   c. Mortgagee's title insurance policy
   d. Abstract of title

15. When a buyer records the deed from the seller, the legal consequence is to
   a. transfer title.
   b. give the seller assurance of holding a first lien.
   c. serve as constructive notice of the buyer's ownership interest.
   d. protect the seller from existing adverse claims.

16. Before closing on the purchase of a duplex, the buyer asked his attorney to render a title opinion. The attorney's title opinion will do all of the following EXCEPT
   a. guarantee the buyer obtains marketable title.
   b. disclose unreleased liens against the property.
   c. disclose personal judgments against the seller.
   d. disclose the amount and status of property taxes and special assessments.

17. Jacobson deeds property to Keene, who neither records her deed nor takes possession of the property. Jacobson later deeds the same property to Linder, who records his deed and takes possession of the property. Linder is not aware of the earlier conveyance to Keene. Who holds legal title to the property?
   a. Jacobson, because Keene did not record her deed
   b. Keene, because her deed is dated first
   c. Linder, because his deed was recorded first
   d. Keene and Linder as tenants in common, because the form of ownership was not specified in the deed

18. Under RESPA, when a borrower applies for a government-insured home mortgage loan, the lender must give the applicant
   a. the annual percentage rate.
   b. a good-faith estimate of closing costs.
   c. a narrative report.
   d. a copy of the listing agreement.

19. RESPA requires lenders to supply which document at closing?
   a. HUD-1 settlement statement
   b. Good-faith estimate
   c. Truth and lending disclosure
   d. ECOA statement

20. The sales price of the property will show on the settlement statement as
   a. debit buyer, credit seller.
   b. debit buyer, debit seller.
   c. credit buyer, credit seller.
   d. debit seller, credit buyer.

21. Monthly HOA dues of $900 were paid in advance on the first of the month with the seller owning the day of closing. For a closing on October 20, the dues would be prorated as
   a. debit buyer, credit seller $300.
   b. debit seller, credit buyer $300.
   c. credit buyer, debit seller $600.
   d. credit seller, debit buyer $600.

22. A prorated item that has been paid in arrears typically shows on the settlement statement as
   a. debit buyer, credit seller.
   b. debit seller, credit buyer.
   c. debit seller, credit broker.
   d. debit seller, debit buyer.

23. An item that has been paid in advance typically shows on the settlement statement as
   a. debit buyer, credit seller.
   b. debit seller, credit buyer.
   c. debit seller, credit broker.
   d. debit seller, debit buyer.

24. Who bears the obligation to disclose lead-based paint in residential properties built before 1978?
   a. Seller
   b. Seller and listing broker
   c. Seller and all brokers
   d. Seller and lender
25. An example of a stigmatized property is one that
   a. suffered from mold.
   b. had not received any offers.
   c. has radon gas issues.
   d. was the site of a suicide.

26. Radon is
   a. considered a stigma that must not be disclosed.
   b. harmless to adults.
   c. a radioactive odorless and colorless gas.
   d. not considered an issue unless discovered.

27. Before closing, a cloud on the title was found. Which of the following should the seller use to clear the title?
   a. Abstract with a title opinion
   b. Title commitment
   c. Title insurance
   d. Suit to quiet title

28. The obligation of real estate professionals in a transaction involving a property built before 1978, which therefore may have lead-based paint, is to
   a. give the buyer the disclosure.
   b. make sure the seller inspects the property and removes all lead-based paint.
   c. make sure all parties are in compliance with the law.
   d. give the buyer an EPA booklet and have the buyer sign the disclosure.

29. All of these are required under RESPA EXCEPT
   a. a disclosure of all closing costs.
   b. the good-faith estimate be given to the buyer within three days of application.
   c. a disclosure of the lender's closing costs only.
   d. a HUD-1 settlement statement at closing.
UNIT 4 QUIZ ANSWERS

1. d  The chain of title links the present owner to all previous owners of the property.
2. c  Clouds are removed from the title in a suit to quiet title.
3. b  Not all real estate documents have to be recorded to be valid (for example, an unrecorded deed can transfer title to the grantee). Recording provides constructive notice of the contents of a document to the public at large.
4. c  Recording requirements are set by state statutes (laws).
5. a  To protect their interests, lenders generally require a borrower to purchase a mortgagee’s title insurance policy (also called a lender’s policy or a loan policy).
6. b  Standard coverage title insurance does not protect against claims involving surveys or encroachments, or other problems that would only be discovered through an inspection of the property.
7. d  The examiner is following the chain of title.
8. d  The mortgagee (lender) wants to make certain that the mortgage is recorded, to provide notice of the mortgagee’s lien against the property.
9. a  A lender (mortgagee) requires the borrower to purchase a mortgagee’s title insurance policy to protect the lender’s security interest in the property.
10. c  Priority of rights is determined by the date of public notice. The most accepted form of public notice is document recordation.
11. a  Deeds need to be acknowledged by the grantor(s) to be recorded.
12. b  A deed that has not been recorded lacks constructive notice, which is also known as legal notice.
13. a  Title insurance policies protect against title flaws that already exist but have not yet been discovered. Therefore, the title company charges only one premium, which is typically paid at closing.
14. b  The best protection for a property buyer is an owner’s title insurance policy.
15. c  Recording serves constructive notice (also called legal notice) of interests in real property.
16. a  An attorney’s title opinion does not guarantee marketable title.
17. c  In a race/notice recording system, subsequent purchasers who record their deed first have good title to the property, as long as they did not have actual notice of the earlier conveyance.
18. b  RESPA requires lenders to give loan applicants a good-faith estimate of closing costs and a HUD booklet about closing costs.
19. a  RESPA requires that lenders provide borrowers with a good-faith estimate of closing costs no later than three days after loan application and a HUD-1 settlement statement at closing.
20. a  The sales price is a debit from the buyer, who agreed to pay the price, and a credit to the seller.
21. a  Items paid in advance will be a buyer owes seller (BOS). Debit the buyer $300 for the portion of the month the buyer will own the property ($900 total dues ÷ 30 total days × 10 days the buyer owns the property = $300).
22. b  Items paid in arrears will be the obligation of the seller. The buyer will be paying the bill sometime in the future, so at closing the seller will have to give the portion the seller owes to the buyer.
23. a  Items paid in advance will be the obligation of the buyer. The seller paid the bill before closing to a date after closing; the buyer will owe the seller for this portion of the month.
24. a  The seller or the landlord is the only one obligated to complete the disclosure. The real estate broker’s obligation is to make sure all parties are in compliance with the law.
25. d  Suicide is considered a stigma, and state law determines whether it may be disclosed.
26. c  Radon is an odorless, colorless radioactive gas and must be disclosed if the seller knows of its presence.
27. d  The seller would use a suit to quiet title. Title commitments and opinions would identify the cloud on the title, but not clear it.
28. c  The obligation of real estate professionals in regard to lead-based paint is to make sure all the parties are in compliance with the law.
29. c  RESPA requires a disclosure of all settlement costs, a good-faith estimate, and a HUD-1 settlement statement.
To whom it may concern:

I have examined the title to the following described premises as the same appears from an abstract of title consisting of 69 entries, which abstract is brought down to date of February 15, 2014, by High Country Abstract Company:

Lot Five (5), Block Three (3), Ridgewood 3rd Addition.

From such examination I am of the opinion that the title to said premises in fee simple is in Gary W. Robinson and Nancy J. Robinson, husband and wife as joint tenants, and that they have a good and marketable title to the same, subject to the rights of any person in possession, to all claims for material or labor furnished within 120 days of the date of certificate, to all questions of surveys, local zoning and building regulations and subject to the following:

1. Restrictive covenants as shown at entry No. 56 of the abstract.
2. Utility easement as shown at entry No. 56 and revised at entries 63 and 67.
3. A mortgage to City Federal Savings and Loan Association of Minneapolis in the original sum of $93,850.00 as shown at entry No. 66 of the abstract.
4. Current taxes of $975.73 are one-half paid.

Yours truly,

Howard S. Wakefield

Howard S. Wakefield

HSW:cfh
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- **distinguish** between implied and express contracts and explain when a contract is considered legally valid,
- **identify** the stages of contracting and the essential elements of a valid contract,
- **explain** when a contract is fully performed and explain when it is in breach, and
- **list** the types of real estate contracts and explain when they are used.

Study Plan

**Before Class:**
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.
Read the Unit 5 Key Points.

**After Class:**
Complete the Glossary Review.
Complete the Review Exam.
KEY POINTS—UNIT 5

- A contract is a legally binding agreement between two or more competent parties to do or not do certain things for consideration. An express contract has been put into words, either spoken or written. An implied contract is created by the actions of the parties.

- In order to comply with the statute of frauds (and be enforceable in court), all contracts for the sale or transfer of real estate must be express written contracts, with the exception of a lease for 12 months or less.

- A breach of contract occurs when a party fails, without legal excuse, to perform any promise contained in the agreement. After a breach of contract, the non-breaching party has four options: acceptance of partial performance, specific performance, liquidated damages, or actual money damages.

- When an agreement doesn’t meet one or more of the requirements for a valid contract, it is considered legally void. If a contract appears to be valid, but has a defect giving one or more of the parties the power to avoid performance and rescind the agreement, it is a voidable contract.

- For a contract to be valid, the parties must have contractual capacity (be over 18 and mentally competent), and there must be mutual agreement between the parties, contractual intent, a lawful objective, consideration, and the document must be in writing (for most real estate contracts).

- To create a valid contract, consent must be freely given. It is not freely given when it is the result of fraud, misrepresentation, duress, undue influence, or mistake. Under these conditions, the contract would be voidable by the disadvantaged party.

- Initially, a purchase agreement serves as the buyer’s offer to purchase and as a receipt for the buyer’s earnest money deposit. After acceptance by the seller, it becomes the contract of sale and the buyer has equitable title until closing, when legal title will be passed.

- An option agreement is a unilateral contract. It creates a right for the optionee/buyer to buy or lease property for a fixed price during a limited period of time. The optioner/seller must hold the property off the market and is obligated to sell if the option is exercised.

- A landlord-tenant relationship is created by a contract called a lease, which creates a leasehold estate. Lease types are distinguished by their different rent structures and include the gross lease (fixed lease), net lease, percentage lease, graduated lease (step-up lease or index lease), land lease (ground lease), and sandwich lease.

- The main types of leasehold estates are the estate for years, the estate from period to period, and the estate at will. An estate for years is a tenancy for a fixed period of time. An estate from period to period automatically renews for a like term as the rent is paid for each period. An estate at will is for an indefinite time period, and it continues until either party gives proper notice of termination to the other party.

- Actual eviction is used by a landlord to remove tenants who are in breach of the terms of the lease. It gives the landlord, after a court hearing, the right to remove the tenants and their possessions from the property.

- Constructive eviction is a wrongful eviction that occurs when the landlord interferes with the tenant’s possession of the leased property or materially disturbs the tenant’s use and enjoyment of the property. This gives the tenant the right to terminate the lease and vacate the property.
A security deposit is any deposit of money meant to secure the performance of a residential rental agreement. When a lease is terminated, the landlord may use the deposit to cover any unpaid rent and pay for any damage caused by the tenant. If any part of the deposit is leftover, it must be returned to the tenant within a time determined by state law.

The enforceability of contracts depends on the legal status of the document (see Figure 5.1).

<table>
<thead>
<tr>
<th>Legal Status</th>
<th>Legal Effect</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Binding and enforceable</td>
<td>An agreement with all the requirements for a valid contract</td>
</tr>
<tr>
<td></td>
<td>Contains all essential elements</td>
<td></td>
</tr>
<tr>
<td>Void</td>
<td>No contract at all</td>
<td>An agreement for which there is no lawful objection</td>
</tr>
<tr>
<td></td>
<td>Missing one or more essential elements</td>
<td></td>
</tr>
<tr>
<td>Voidable</td>
<td>Valid until rescinded by one party</td>
<td>A contract entered into by a minor or under duress or due to fraud or misrepresentation</td>
</tr>
</tbody>
</table>
I. HOW A CONTRACT IS CREATED

A contract is a voluntary, binding agreement between two or more competent parties to do (or not do) a specific thing.

A. Implied contract

1. 

2. No implied contracts in transfer of any interest in real estate

B. Express (declared) contract

1. Can be oral or written
   a) To be enforceable, the majority of real estate contracts must be

2. Bilateral
   a) Promise exchanged for a promise
   b) Both parties are bound to perform
   c) Example: Purchase agreement—“I promise to sell and you promise to buy”

3. Unilateral
   a) Promise exchanged for performance
   b) ____________________ is bound
   c) Example: Option contract—“I promise to sell if you decide to buy”

II. CLASSIFICATION OF CONTRACTS

A. Valid

1. Meets all legal requirements; contains ________________________________

2. Binding and enforceable in court by both parties

B. Void

1. No legal effect; not enforceable by either party

2. Lacks one or more of the essentials elements of a valid contract
   a) Example: An oral contract for the purchase of real estate

C. Voidable

1. A voidable contract appears to be valid, but one party may disaffirm it because the party is a 
   __________________________ or was subject to ________________________________.

2. The disadvantaged party may take legal action to disaffirm the contract.
III. STAGES OF A CONTRACT

A. Offer

1. This is a negotiation period, so no contract exists yet.

2. The offer may be countered and new offers made until there is a
   __________________________________________________________________________.
   a) In the offer stage, earnest money is not usually deposited because there is not a contract yet.

3. Any strike-through changes on an offer must be initialed (and dated for clarity) by all parties to be enforceable.

4. Upon a meeting of the minds and communication of acceptance by the parties, a contract is formed.

5. Termination of the offer prior to acceptance can occur through any of the following:
   a) Counteroffer
      (1) Any change to an offer will terminate the offer and create a counteroffer.
   b) Revocation or withdrawal by offeror
   c) Rejection by offeree
   d) Lapse of an unreasonable time
   e) Event that destroys the property (i.e., a fire)
   f) Death of either party

B. Contract

1. All parties must abide by the terms of the __________________________________________________________________________.
   a) Typically the earnest money for a purchase contract is deposited based on state laws.

2. In order for the contract terms to be changed, __________________________________________________________________________ must be negotiated and signed by all parties.

C. Termination

■ Determined by the contract

1. Lease—on expiration date or notice as determined by the lease contract

2. Option—on expiration date unless option is exercised; then the option will need a purchase contract to close

3. Purchase contract—either by a party exercising a contingency and terminating, or at closing with conveyance of the deed
   a) After closing, the contract is considered executed.

4. Breach—nonbreaching party will have remedies per the contract against the breaching party
IV. **ESSENTIAL ELEMENTS OF A VALID CONTRACT**

A. **Contractual capacity/legally**

1. Must be ______ years old or an emancipated minor

2. Must be _______________________________________
   a) Persons determined to be incompetent __________________________ cannot enter into a contract unless the court authorizes someone to act on their behalf.

B. **Mutual agreement/consent/**

■ Must have a _________________________________________

1. Offer accepted and communication of acceptance given before the offer is withdrawn
   a) The __________________________ becomes binding upon __________________________.
   b) If the offer is withdrawn before communication of acceptance, there is no contract.

2. Counteroffer—a change of any conditions in the offer
   a) Legally, a rejection __________________________ (but it usually carries forward many terms from the original offer).
      (1) A counteroffer is not partial acceptance, partial rejection, or partial termination; a counteroffer terminates the original offer and creates a new one.
   b) In a counteroffer, the original offeree becomes the offeror.
   c) A seller who gave a buyer a counteroffer with three days to accept and then received a new and better offer from another buyer must withdraw the counteroffer prior to accepting the new offer.
   d) A buyer who receives a counteroffer does not need to respond to it prior to writing an offer on a different property.
   e) A seller who makes changes to the offer document and initials and signs the offer has created a counteroffer.

3. Contractual intent—reality of consent
   a) Intent to be bound

4. **No fraud or misrepresentation**
   a) The parties may not make false statements or __________________________.
      (1) A material fact is one that, if known, might change a decision and __________________________.
   b) This does not include __________________________ (the act of making a claim that anyone would understand is not literally true).
   c) A broker may rely on a seller's statement of repair unless it is apparent that it is not true.
d) *Caveat emptor* means “let the buyer beware”; the use of this phrase is not common due to disclosure requirements.

e) Sellers must disclose all material defects and facts even if selling “as is.”

5. No duress or menace
   a) No force or threat

6. No undue influence
   a) No unfair advantage

7. No mutual mistake
   a) No mutual misunderstanding

C. **Lawful objective**

1. The contract must have a legal purpose.

2. The contract would be void if the use of the property was banned during the contract period.

D. ________________________________

1. Consideration is money, promises, or something of value.

2. ________________________________ for a sales contract and therefore is not required; earnest money is liquidated damages.

E. **In writing and signed**

**FIGURE 5.2**

<table>
<thead>
<tr>
<th>Essential Elements of a Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Competent parties</td>
</tr>
<tr>
<td>2. Meeting of the minds</td>
</tr>
<tr>
<td>3. Lawful objective</td>
</tr>
<tr>
<td>4. Consideration</td>
</tr>
<tr>
<td>5. In writing and signed</td>
</tr>
</tbody>
</table>

V. **STATUTE OF FRAUDS AND STATUTE OF LIMITATIONS**

A. **Statute of frauds**

1. The statute of frauds requires that, in order to be enforceable, certain contracts must be expected to perform.

2. The statute-of-frauds requirement includes all contracts for the transfer of __________________________.

   a) An exception is a lease for 12 months or less.

   b) The purpose is to prevent problems associated with oral contracts.

B. **Statute of limitations**

1. The statute of limitations sets the amount of time parties will be given to file a claim or lawsuit.
VI. PERFORMANCE AND DISCHARGE

A. Executory versus executed
   1. Executory—not ______________________________
      a) The executory period starts upon communication of acceptance of the offer.
   2. Executed—duties fully performed
      a) Purchase agreement is executed once the deed has been delivered and accepted.

B. Addendum
   1. Additional material attached to and made ______________________________ (e.g., disclosures and contingencies)

C. Amendments/modification
   1. ______________________________ of contract terms by mutual agreement
   2. Must be ______________________________ by all parties

D. Assignment
   1. Transfers ______________________________, but not liability

E. Novation
   1. Transfers contract rights and liability
   2. ______________________________

F. Legal impossibility/impossibility of performance
   1. A duty required by the contract that cannot be legally performed

G. Death
   1. Most contracts are not terminated by death, so the deceased's estate would have to honor the contract.
      a) Contract would terminate when there is no one left to perform.
   2. Certain contracts may be terminated by death.
      a) Example: personal services contract, such as listings
   3. Offers, which are not contracts, terminate upon death of the parties.

H. Mutual rescission
   1. Return of all parties to their original condition before contract was executed (earnest money ______________________________)
VII. REMEDIES FOR BREACH OF CONTRACT/DEFAULT

A. How a breach of contract occurs

1. A breach of contract is when one party is in default without a legal excuse.
   a) If a seller takes fixtures after closing that were not excluded from the purchase agreement, the seller would be in breach.
   b) If a buyer's earnest money check were to be returned for nonsufficient funds, the buyer would be in breach.
   c) The __________ sets forth the amount of time that the nonbreaching party has to take legal action against the breaching party.

B. Remedies for the nonbreaching party

1. Acceptance of partial performance
   a) __________

2. Specific performance
   a) Sue to force performance—"for __________"
   b) Available to __________ buyer and seller
   c) Buyer's only remedy if the seller decides not to sell

3. Liquidated damages (available only if specified in the agreement)
   a) Retain breaching party's deposit (i.e., earnest money, damage deposit)
      (1) Earnest money is liquidated damages, not consideration
   b) Available __________ in a purchase contract

4. Actual damages
   a) Sue for __________

VIII. TYPES OF REAL ESTATE CONTRACTS

A. Purchase agreement

■ Creates the conditions for closing
■ Also known as offer to purchase, contract of sale, or purchase and sale agreement

1. The offer becomes an __________ contract upon communication of acceptance.
   a) Communication of acceptance is when the last party has signed and the other party has been notified.
   b) Oral notification of written acceptance is adequate.

2. It is a bilateral agreement, so it is binding on both parties.
   a) Purpose: I promise to buy, and you promise to sell.
3. The parties are the following:
   a) Seller is vendor—holds __________________________
   b) Buyer is vendee—holds __________________________ (“equitable owner”)

4. The essential elements include the buyer’s and the seller’s signatures, property description, price and terms, and in writing and signed.

5. The contract typically includes one or more __________________________ stating that the party will not be responsible for completing the purchase under certain conditions.
   a) Typical contingencies are for financing, appraisal, and inspection.
   b) If the buyer terminates per a contingency, the __________________________ and the contract is terminated.
   c) The broker is not entitled to a commission if the contract is terminated per a contingency.

6. The contract often includes a “time is of the essence” clause, which requires exact adherence to dates specified or the party will be in breach.

7. A risk of loss statement is determined by state law or contract provision.

**FIGURE 5.3**

**The Stages of a Real Estate Purchase Contract**

<table>
<thead>
<tr>
<th>Stage</th>
<th>1. Listed</th>
<th>2. Offer, acceptance, and communication of acceptance</th>
<th>3. Under contract (with or without earnest money)</th>
<th>4. Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Features</td>
<td>On the market</td>
<td>Offeror—made last offer</td>
<td>Buyer (vendee) has equitable title (owner in equity)</td>
<td>Transfer of legal title to buyer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Offeree—received last offer</td>
<td>Seller (vendor) retains legal title</td>
<td>Deed:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Attachments—explain</td>
<td>Amendments modify contracts</td>
<td>Grantor = seller</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Addenda(ums) are attached to offers</td>
<td></td>
<td>Grantee = buyer</td>
</tr>
</tbody>
</table>

| Key Points | Acceptance must be communicated to offeror to form binding contract | Executory period | Earnest money deposited upon acceptance of the offer | Executed |
| | Earnest money attached to offer & in broker’s safekeeping | | | Buyer receives credit for earnest money at closing |

**B. Option**

1. Definition: A potential buyer purchases the right to buy in the future from a seller who agrees to sell within a set period for a set price

2. Purpose: I promise to sell if you decide to buy

3. Unilateral agreement—binding on seller and buyer has option/choice to perform
   a) Original contract contains all terms that will be binding if the option is exercised.
   b) It becomes bilateral when exercised by the optionee.
   c) If the option is not exercised, it expires at the end of the option period.
4. Parties
   a) Owner—optionor
   b) Potential buyer—optionee

5. Option fee
   a) It typically includes a nonrefundable option fee to hold the option for the buyer.
      (1) The parties can negotiate whether the option fee will be applied toward the purchase price if the option is exercised.
   b) If the buyer decides not to buy, the seller does not have any ________________ except to keep the buyer’s option fee.

C. Lease-purchase
   1. Used when a tenant wants to purchase a property but can’t get financing for the full amount
   2. Part of the rent may be applied to the purchase price; contract terms dictate conditions

D. Right of first refusal
   1. The right of first refusal is the right of a person to have the first opportunity to purchase or lease real property.
   2. This right is sometimes part of condominium or cooperative rules and regulations or part of a lease.
   3. It gives the owner ________________ than an option because there is typically no set price and the seller can sell to others if the first right is not exercised.

E. Sale-leaseback
   1. Owner sells property to investor and leases it back
   2. Converts equity to working capital without giving up possession

F. Lease
   1. Purpose: I promise to let you occupy and you promise to pay rent
   2. Bilateral
   3. Parties
      a) Landlord = ________________
      b) Tenant = ________________
   4. Essential elements include the following:
      a) Names of lessor and lessee (landlord and tenant)
      b) Description of property
      c) Rent terms
5. Lessor has reversionary interest, allowing lessor to retake possession

6. Termination set by date or notice in lease
   a) Sale of property does not terminate lease.
   b) Buyer takes title “subject to” the lease.

7. Types of leases
   a) Gross/fixed: tenant pays ________________________ and landlord pays all expenses
      (1) Most typical for residential, but could be used for commercial properties
   b) Commercial leases include the following:
      (1) Net: tenant pays ________________________ (e.g., property
taxes, insurance, maintenance)
      (2) Percentage: rent based on a percentage of ______________________;
          most typical in retail properties
      (3) Variable: rent increases or decreases at predetermined intervals
          (a) Graduated: rent increases at predetermined intervals and amount set in lease terms
          (b) Index: rent is adjusted based on an economic indicator (e.g., consumer price index)
      (4) Ground (land): used to rent unimproved property
          (a) Improvements usually become the landlord’s property at the end of the lease.
          (b) Tenant would want a ______________________ if adding
              improvements.

8. Termination of lease based on expiration date of lease or required notice
   a) Estate for years
      (1) ______________________ (not death)
   b) Periodic estate
      (1) Notice (not death)
   c) Estate at will
      (1) Notice or death
   d) Actual eviction
      (1) Court action brought by the landlord against a tenant who is in breach
   e) Constructive eviction
      (1) Lease terminated if lessee must vacate due to lessor’s act or failure to act
      (2) Cancels lease and tenant’s obligation to pay rent, but the tenant must move
UNIT 5 GLOSSARY REVIEW

(Some words may be used twice.)

addendum  express  offeree
amendment fraud offeror
bilateral gross lease offeror
communication of implied option
acceptance lawful objective specific performance
consideration lease statute of frauds
counteroffer liquidated damages unilateral
earnest money mutual agreement valid
executory net lease void

1. A contract whose terms have been explicitly declared either verbally or in writing is a(n) ________________ contract.

2. When only one party to the agreement makes a promise, the result is a __________________________ contract.

3. A contract in which one party has the right to void the contract is a __________________________ contract.

4. A contract created by the actions of the parties is a(n) __________________________ contract.

5. A contract with a minor will be __________________________.

6. A lease agreement in which the tenant pays rent only is a __________________________.

7. A lease agreement in which the tenant pays rent plus operating expenses is a __________________________.

8. A unilateral contract in which Buyer Allen has the right to purchase a property from Seller Betty if Buyer Allen chooses to do so is a(n) __________________________.

9. A party attempting to enforce an oral executory contract for the purchase of real estate would be stopped by the __________________________.

10. ________________ means that there was an offer and acceptance; there was no fraud, misrepresentation, or mistake; and the consent was genuinely and freely given.

11. The party who makes an offer to another is known as the __________________________.

12. An accepted offer becomes binding on the offeror upon __________________________.

13. Actual knowledge to enter into a contract by intentionally deceiving a party is __________________________.

14. Something of value given in exchange for something else of value is __________________________.

15. __________________________ is not consideration but may be required as part of liquidated damages in a purchase contract.

16. Additional material attached to and made part of an offer is an __________________________.

17. To modify a written contract, both parties must sign an __________________________.

18. The buyer has equitable title in an __________________________ contract.
19. The right of parties to a contract to sue each other to perform the contract terms is
______________________________.

20. When the seller keeps only the earnest money or other things of value of a buyer who is in default, the
contract remedy is ________________________________.
UNIT 5 QUIZ

1. A contract that has NOT yet been fully performed is
   a. unenforceable.
   b. voidable.
   c. executory.
   d. executed.

2. A contract that exchanges a promise for performance is
   a. implied.
   b. unilateral.
   c. bilateral.
   d. executory.

3. All of these are essential elements of a contract EXCEPT
   a. mutual agreement.
   b. a lawful objective.
   c. consideration.
   d. earnest money.

4. The electrical wiring in a house is defective. The broker who listed the house is aware of this and intentionally deceives a potential buyer about it. The buyer purchases the home and later suffers a financial loss due to the faulty wiring. This is an example of
   a. mistake of law.
   b. fraud.
   c. mistake of fact.
   d. novation.

5. Which of the following requires that real estate sales contracts be in writing?
   a. Caveat emptor law
   b. Truth in Lending Act
   c. Statute of limitations
   d. Statute of frauds

6. Which of the following statements regarding a purchase agreement is TRUE?
   a. The contract is binding on both parties.
   b. The contract may be oral.
   c. The contract terms must be identical to the terms in the listing agreement.
   d. The contract conveys legal title when signed by both parties.

7. A contract that conveys the right to quiet enjoyment and use of property but does NOT convey title is a
   a. bill of sale.
   b. lease.
   c. quitclaim deed.
   d. dedication.

8. A new contract that transfers all rights and liabilities is
   a. an assignment.
   b. a subordination.
   c. a novation.
   d. an option.

9. A seller may keep the buyer’s earnest money as liquidated damages if
   a. that is stated in the listing agreement as a remedy for the seller.
   b. the seller and the broker agree that the buyer defaulted and the contract calls for specific performance.
   c. the buyer defaults and the purchase agreement stipulates liquidated damages as a remedy.
   d. the seller failed to perform an essential element of the contract.

10. A contract in which one party purchases the right to buy at a fixed price within a specified period is
    a. a purchase agreement.
    b. a listing agreement.
    c. a lease.
    d. an option.

11. A contract between two parties that legally binds one party to perform, but allows the other party to disaffirm it, is
    a. executed.
    b. void.
    c. voidable.
    d. bilateral.
12. A buyer signed a purchase agreement, but then the seller decided not to sell. The buyer sued the seller successfully and was able to purchase the house. What was the contract remedy if the seller was in default?
   a. Unilateral rescission
   b. Mutual agreement
   c. Specific performance
   d. Damages

13. When a party is in default in a contract due to missing a payment deadline, the contract is considered
   a. breached.
   b. executed.
   c. unilateral.
   d. illegal.

14. A commercial lease in which the tenant pays the landlord a base rent plus a share of the gross sales from the tenant's business, is a
   a. net lease.
   b. ground lease.
   c. gross lease.
   d. percentage lease.

15. A commercial lease that requires the tenant to pay a percentage of the property's operating expenses is a
   a. percentage lease.
   b. net lease.
   c. gross lease.
   d. standard lease.

16. A landlord has not paid the utility bills for his apartment building, so the heat, water, and electricity are shut off. Because of this, the tenants move out and have the right to terminate their leases. Which of the following legal concepts does this example illustrate?
   a. Constructive eviction
   b. Mutual rescission
   c. Actual eviction
   d. Eminent domain

17. Upon acceptance and communication of acceptance, an offer is considered
   a. a counteroffer.
   b. unilateral.
   c. a contract.
   d. valid.

18. If a commercial tenant only pays rent, the tenant MOST likely has a
   a. gross lease.
   b. net lease.
   c. percentage lease.
   d. ground lease.

19. In an executory purchase contract, the buyer's interest is described as
   a. legal title.
   b. ownership in equity.
   c. naked legal title.
   d. free and clear title.

20. The buyer and the seller have entered into a binding contract for sale. However, before closing the law changes and the buyer's intended use of the property becomes illegal. Which is TRUE?
   a. The contract is valid and enforceable under the rules of risk.
   b. The contract is terminated due to fraud by the seller.
   c. The contract is void due to impossibility of performance.
   d. The contract is valid but the price must be renegotiated.

21. Consideration could be all of the following EXCEPT
   a. a promise.
   b. money.
   c. something of value.
   d. earnest money.

22. Two forms of eviction are
   a. sheriff and trustee.
   b. actual and constructive.
   c. landlord and tenant.
   d. judicial and sufferance.

23. When the buyer is in default and the seller keeps the earnest money, the contract MOST likely provided for
   a. specific performance.
   b. actual damages.
   c. executed damages.
   d. liquidated damages.
24. Alice is a minor who entered into a contract to sell to Bob the house she had inherited. This contract is MOST likely
   a. valid.
   b. void.
   c. voidable by Bob.
   d. voidable by Alice.

25. The remedy for parties in default that is available to both the buyer and the seller in a purchase contract is
   a. specific performance.
   b. liquidated damages.
   c. actual damages.
   d. lis pendens.

26. The seller told the buyer that the property had no roof leaks. But when the buyer had the property inspected, a roofing contractor found leaks and said they had been leaking for months. The contract between the seller and the buyer is probably
   a. void.
   b. voidable.
   c. valid.
   d. implied.

27. Contracts that transfer interests in real estate should be
   a. implied contracts.
   b. unilateral contracts.
   c. bilateral contracts.
   d. express written contracts.

28. A contract between two parties who each make a promise to perform certain acts is called
   a. a bilateral contract.
   b. a unilateral contract.
   c. an implied contract.
   d. a voidable contract.

29. A real estate contract with a minor is
   a. voidable.
   b. void.
   c. unilateral.
   d. illegal.

30. A purchase agreement would likely be voidable under all of these circumstances EXCEPT
   a. the purchaser is a minor.
   b. the seller signed under duress.
   c. the buyer didn't read or understand the contract.
   d. the seller made a material misrepresentation to the buyer.
UNIT 5 QUIZ ANSWERS

1. c Before execution, the contract is executory.
2. b A promise for a promise is bilateral; a promise for performance is unilateral.
3. d Earnest money is not an essential element of a contract. Earnest money is liquidated damages for the seller to retain in the event of the buyer's breach.
4. b Intentional deceit is fraud.
5. d The statute of frauds requires all real estate contracts (except leases for one year or less) to be in writing.
6. a A purchase agreement is binding on both the buyer and the seller.
7. b The lessor (landlord) grants the right of possession to the lessee (tenant); the lessor retains title.
8. c A transfer of contract rights and liabilities to another using a new contract is a novation.
9. c If the buyer breaches the purchase agreement, the seller may keep the earnest money as liquidated damages if the purchase agreement provides for that remedy.
10. d In an option, the optionee purchases the right to buy.
11. c In most voidable contracts, only one of the parties is legally bound to perform.
12. c An order of specific performance requires the defaulting party to perform as agreed in the contract.
13. a A party who is in default in a contract is said to be in breach.
14. d Percentage leases are used for commercial and retail properties.
15. b In a net lease, the tenant pays a base rent plus some or all of the operating expenses.
16. a In a constructive eviction, the tenant terminates the lease because the landlord has caused or permitted a substantial interference with the tenant's use and enjoyment of the property.
17. c Upon communication of acceptance, the offer becomes a contract. The offer and contract could be invalid if they were missing an essential element, such as competent parties.
18. a In a gross lease, the tenant only pays rent and the landlord pays all expenses. It is typically used in residential leasing, but could also be used for commercial properties.
19. b Under a purchase agreement or a contract for deed, the buyer holds equitable title. The seller holds legal title until the seller delivers the deed to the buyer.
20. c When a change in law makes the purpose of a contract illegal, it is void due to impossibility of performance (it now lacks a legal purpose).
21. d Earnest money is a remedy for default and not part of consideration.
22. b Actual eviction is what a landlord uses when tenants are in default; constructive eviction is what tenants may claim if the landlord is in default.
23. d Earnest money is what the buyer gives the seller in case the buyer defaults on the contract. It is typically the only thing the seller will receive in a liquidated damages contract.
24. d Contracts with a minor are voidable by the minor, not the adult.
25. a Specific performance is the only standard remedy for default that is available to both parties in a purchase agreement.
26. b The contract is voidable due to fraudulent misrepresentation of the condition of the property.
27. d Express (meaning that the terms are specifically identified in the contract) written contracts are used in the transfer of real estate.
28. a A bilateral contract contains a promise from each party.
29. a The contract is voidable because the minor could disaffirm it.
30. c Failure to read the contract does not allow a party to withdraw.
**LEARNING OBJECTIVES** When you have completed this unit, you will be able to

- **explain** the purpose and function of appraisals in real estate transactions,
- **identify** the elements and principles of value and how each impacts the value of real property,
- **summarize** the methods for valuing property for appraisal purposes, and
- **discuss** how and why appraisers reconcile the three approaches to value.

**Study Plan**

**Before Class:**
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.
Read the Math Refresher and Unit 6 Key Points.

**After Class:**
Complete the Glossary Review.
Complete the Review Exam.
An appraisal is an estimate or opinion of value. A common definition of value is the present worth of future benefits. For appraisal purposes, value is generally measured in terms of money.

Appraisers must be licensed. Brokers and salespeople may complete a competitive market analysis (CMA) but should clearly identify that the CMA is not an appraisal.

An appraisal is required for all federally related loans (e.g., conventional, FHA, or VA loans from any federally regulated lender).

The four essential elements of value for real property are demand, utility, scarcity, and transferability (use the memory aid DUST). If any of these items are missing, the property may have less or no value.

Appraisers have developed principles of value to guide them in the appraisal process. These include the principle of highest and best use, the principle of anticipation, the principle of supply and demand, the principle of substitution, the principle of conformity, and the principle of contribution.

Steps in the appraisal process include defining the problem, gathering and verifying general and specific data, applying one or more of the three approaches to value (sales comparison, cost, and income approaches), and weighing each approach (reconciliation) to arrive at a final estimate of value, which is written in an appraisal report.

In the sales comparison approach (the method most often used for appraising residential property), the prices of sold properties comparable to the subject property are adjusted in relation to the subject to determine the subject property's market value.

In the cost approach, the appraiser estimates the cost of replacing or reproducing the property improvements, deducts estimated depreciation, and adds the estimated value of the land. Depreciation is a loss in value due to any cause, including physical deterioration, functional obsolescence, and economic obsolescence.

In the income approach, the net operating income generated by the subject property is capitalized (estimating present value based on current or expected income) to arrive at an estimate of value. Real estate investors are concerned about the capitalization rate or rate of return of their properties.

Reconciliation is the process where different approaches are weighed and final value is determined.
Appreciation and Depreciation Calculations

The following circle formula applies to any situation involving appreciation or depreciation:

\[
\frac{A}{\text{Per}} \times B
\]

- \(A\) = the value after the percent change
- \(B\) = the value before the percent change
- \(\text{Per}\) = the formula percentage

Formula percentage (\(\text{Per}\)) is:
- \(100\% + \) the gain (appreciation), or
- \(100\% – \) the loss (depreciation)

Note: Because \(\text{Per}\) is always 100\% plus or minus something, it is never the answer to a problem. Always adjust up or down from 100\% to find the value needed.

Question 1: A property purchased three years ago for $200,000 has appreciated 16\%. What is its current value?

\[
\text{Per} = 100\% + 16\% = \underline{1.16}
\]

\[
B = $200,000
\]

\[
A = \frac{\text{Per} \times B}{1.16} = \frac{1.16 \times $200,000}{1.16} = $232,000
\]

Question 2: A property recently appraised for $275,000. Since it was purchased, it has appreciated 10\%. What was the original purchase price?

\[
\text{Per} = 100\% + 10\% = 110\%
\]

\[
B = \frac{A}{\text{Per}} = \frac{$275,000}{1.10} = $\underline{250,000}
\]

Question 3: A property has a current value of $210,000. It has depreciated 25\% since it was purchased two years ago. What was the original value?

\[
\text{Per} = 100\% – 25\% = \underline{0.75}
\]

\[
B = \frac{A}{\text{Per}} = \frac{$210,000}{0.75} = $\underline{280,000}
\]

Solutions:

- Question 1: \(A = \text{Per} \times B = 1.16 \times $200,000 = $232,000\)
- Question 2: \(B = A \div \text{Per} = $275,000 \div 1.10 = $250,000\)
- Question 3: \(B = A \div \text{Per} = $210,000 \div 0.75 = $280,000\)
I. **APPRaisal**

A. **Definition of an appraisal**

1. An ____________________________ of market value supported by an analysis of relevant property data
   a) Appraisals are regulated at both the state and federal level.
      (1) Must be done by a licensed appraiser
      (2) More accurate than a CMA or broker’s price opinion (BPO)
   b) The Uniform Residential Appraisal Report (URAR) is the standard form typically used for residential appraisals.

B. **Appraisal licensing**

1. Appraisers must be licensed or certified according to state law, and in accordance with federal regulations.
2. Appraisers may have further designations such as MAI (Member of the Appraisal Institute) or SRA (Senior Residential Appraiser) from the Appraisal Institute.
3. Appraisers are also expected to follow the Uniform Standards of Professional Appraisal Practice (USPAP).

C. **Purpose and function of appraisals**

1. Most appraisals seek to estimate market value on behalf of a lender but could also be used by sellers estimating the market value of their property.
   a) An appraisal is required for all ____________________________, such as conventional, FHA, and VA loans from regulated lenders; it is not required for seller-carry loans.
   b) An appraisal assures that the relationship between the amount of the loan and the value of the property is appropriate (loan-to-value ratio).
2. Appraisals are also used for insurance, condemnation proceedings, and so on.

D. **CMA/BPO/broker opinion of value (BOV)**

1. A real estate licensee’s job is to perform a competitive market analysis, not an appraisal.
2. The licensee researches and evaluates comparable properties that have recently sold.
   a) It is similar to the sales comparison approach (will be covered later).
3. A CMA/BPO/BOV assists a seller and a buyer in determining value.
4. A broker may charge a fee for the CMA/BPO/BOV, but should make it clear that it is ____________________________.
II. **VALUE**

A. **Market value**
   - What the market will pay
   1. The most ____________________________ (in terms of cash or its equivalent) that a property should bring when
      a) a willing seller would sell and a willing buyer would buy;
      b) the property is exposed on the open market for a reasonable time;
      c) both parties are familiar with the property's uses, defects, and advantages; and
      d) neither party is under abnormal pressure to sell or buy.

B. **Market price**
   - What someone actually paid
   1. ____________________________ or what someone actually paid
   2. Historical fact

C. **Essential elements of value (DUST)**
   1. ____________________________
      a) Desire
      b) Affordability
   2. ____________________________ (usefulness)
      a) Does the property fulfill a specific need?
      b) It is subjective; based on needs and desires of specific potential buyer.
   3. ____________________________
      a) There is a finite supply of land.
      b) Land in specific areas is limited (scarce).
   4. ____________________________
      a) Must have marketable title

III. **PRINCIPLES OF VALUE**

A. **Highest and best use**
   1. The highest and best use is the use that produces the best return on investment over time.
   2. It typically is the current use, but it could be different.
      a) The highest and best use of a property can change over time, but there can only be one highest and best use at a time.
3. The appraiser must show current

   a) It would not be included in a CMA/BPO/BOV.

B. Anticipation

1. Future benefits determine the current value.
2. Real estate values are driven by the anticipation of future benefits.

C. Supply and demand

1. Seller's market versus buyer's market
2. Supply: number of available properties (of a certain type in a certain area)
   a) Price moves opposite of supply; when supply goes up, price goes ________________.
3. Demand: number of properties that will be purchased
   a) Price moves with demand; when demand goes up, price goes ________________.
4. Determines __________________________________________________________________

D. Substitution

1. Substitution is the most important principle in appraisal.
2. It is the basis of the sales comparison approach and is used in ____________________________________________________________________.
3. In real estate (like any commodity), the lowest price with the highest value will sell first.
   a) The buyer considers the cost of acquiring an equally desirable substitute that meets the same
      criteria of time, function, and utility.
   b) To be accurate, all approaches to value must consider what the market will pay.

E. Conformity

1. Values tend to move toward surroundings.
   a) Value is impacted when properties are different sizes or have different amenities in the same
      area.
2. Regression is when the value of overimproved property ________________.
3. Progression is when the value of underimproved property ________________.
4. Values are most stable when all properties are similar.
   a) Example: A large house in a neighborhood with small houses will not have as high of value
      as if it were located near other large properties.
F. Contribution

1. Contribution determines the increasing or decreasing returns on improvements.

2. The value of an improvement is not what it costs to build but what it adds to the market value of the property.

3. __________________________ are improvements that add more value than they cost.

4. __________________________ are improvements that add less value than they cost.

5. Value is determined by what the market will pay, not by the price of an improvement or the cost of installation.

   a) Example: A swimming pool that costs $5,000 to purchase and install might add $10,000 in value in California, but in Minnesota, it might decrease value of the property by $10,000.

IV. METHODS OF VALUATION

A. Sales comparison/market data approach

1. Key points

   a) It is the most important method for residential property and vacant land.

   b) The estimate of value is based on adjusted sale prices of similar properties that were recently sold.

      (1) It is similar to what brokers use to determine value when doing a CMA.

2. Area of improvements (square feet)

   a) Square feet is typically based on exterior dimensions of the finished, heated living area.

      (1) The finished areas above and below grade have different values.

   b) Square footage is often determined by local, state, or multiple listing service (MLS) guidelines.

3. Subject property

   a) Property being appraised

   b) __________________________

4. Comparable sales (comps)

   a) Comparables are similar properties that recently sold.

   b) Adjustments are always made to the __________________________ to make them similar to the subject.

   c) The comparables with the least adjustments generally give a stronger indication of value.

      (1) In a rapidly changing market, comparables that have sold __________________________ and up to 12 months should be used.
5. Primary elements of comparison and adjustment
   a) Lot size
   b) __________________________ (values may be appreciating or depreciating)
      (1) Market cycles often create the need for a “time of sale” adjustment.
   c) Days on market
   d) Amenities
   e) Exterior dimensions of improvements (square footage)
   f) Not the purchase price or acquisition cost of subject property

6. Adjustments are made to the ______________________
   a) Adjust comparable to make it similar to the subject
      (1) If comp is better than subject, ______________________
         (a) Example: The subject property has one bathroom and the comparable has two. Subtract the value of the extra bathroom from the comparable’s sale price to make it match the subject property.
         (2) If comp is worse than subject, ______________________

**FIGURE 6.1**
Adjusting Comparables

![Diagram showing adjustments between two properties]  

b) Value of adjustments may be determined by doing a paired sales analysis
   (1) The appraiser finds two properties that are nearly identical, with the exception of the item being adjusted (e.g., a bedroom, fireplace, or other improvement).
   (2) Find the value of the bedroom by determining the difference in sale price of the two properties.
      (a) Example: Determine the value of a bedroom in two nearly identical properties.
         ■ Comp 1 has three bedrooms and sold for $250,000.
         ■ Comp 2 has four bedrooms and sold for $254,500.
         ■ Using the paired sales method, the value of the bedroom is $4,500 ($254,500 – $250,000 = $4,500).
(3) The value is not based on what the improvement cost to purchase and/or install but on what the market will pay for it.

(a) Example: The subject property is a three-bedroom, two bath ranch-style home with a two-car garage. Based on these comparables, what is its indicated market value?

<table>
<thead>
<tr>
<th></th>
<th>Subject</th>
<th>Comp #1</th>
<th>Comp #2</th>
<th>Comp #3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of bedrooms</strong></td>
<td>3 BR</td>
<td>2 BR</td>
<td>3 BR</td>
<td>3 BR</td>
</tr>
<tr>
<td><strong>Number of bathrooms</strong></td>
<td>2 BA</td>
<td>2 BA</td>
<td>1 BA</td>
<td>3 BA</td>
</tr>
<tr>
<td><strong>Garage type</strong></td>
<td>2 Car</td>
<td>2 Car</td>
<td>2 Car</td>
<td>2 Car</td>
</tr>
<tr>
<td><strong>Style</strong></td>
<td>Ranch</td>
<td>Ranch</td>
<td>Ranch</td>
<td>Ranch</td>
</tr>
<tr>
<td><strong>Sold price</strong></td>
<td>---</td>
<td>Sold $110,000</td>
<td>Sold $111,000</td>
<td>Sold $120,000</td>
</tr>
<tr>
<td><strong>Adjustment</strong></td>
<td>---</td>
<td>+ $4,500</td>
<td>+ $4,000</td>
<td>- $4,000</td>
</tr>
<tr>
<td><strong>Value</strong></td>
<td>?</td>
<td>$114,500</td>
<td>$115,000</td>
<td>$116,000</td>
</tr>
</tbody>
</table>

**FIGURE 6.2**

**Adjusting Comparable Property Selling Prices**

B. Cost approach

1. Key points
   a) It is the most important method for new construction and unique or ______________, such as churches and schools.
   b) The cost approach is typically used when comparable sales or income is lacking.

2. Three steps in cost approach
   a) Estimate the cost to build the improvements if built now, which may be based on reproduction or replacement cost
   b) Estimate and deduct accrued depreciation in the subject property
   c) Add the value of the land
      (1) Land does _______________________________, so its value must be deducted from the improvements that depreciate.
      (2) It is usually evaluated using the market data approach, and then value is added to find the final value.
   d) Formula: cost to build new – accrued depreciation + land value = value

3. Cost to build new (uses only one of these methods)
   a) Reproduction cost new
      (1) Cost to build a ______________________ with same or highly similar material
      (a) Used for historic properties
   b) Replacement cost new
      (1) Cost to replace improvements with the same functionality/____________________
4. Categories of depreciation
   a) Key points
      (1) Depreciation is a ____________________________ for any reason.
      (2) Depreciation affects improvements, not land.
      (3) There are three types of depreciation.
   b) Physical deterioration (also called obsolescence)
      (1) Deferred maintenance
      (2) ____________________________
   c) Functional obsolescence
      (1) Design or other inadequacies, including obsolete equipment, poor floor plan, and so on
         (a) Examples: outdated lighting and plumbing fixtures or a four-bedroom home with one bathroom
      d) Economic obsolescence (also called locational obsolescence or external obsolescence)
         (1) External factors/location/surroundings—determined through a neighborhood analysis
            (a) Example: property is in a flight path from a nearby airport
            (2) ____________________________

5. Appreciation and depreciation calculations
   a) The following circle formula applies to any situation involving appreciation or depreciation:

      \[
      A = \text{the value after the percent change} \\
      B = \text{the value before the percent change} \\
      \text{Per} = \text{the formula percentage} \\
      
      \text{Formula percentage (Per) is:} \\
      100\% + \text{the gain (appreciation)}, \text{or} 100\% - \text{the loss (depreciation)}
      \]

      (1) Note: Because Per is always 100\% plus or minus something, it is never the answer to a problem. Always adjust up or down from 100\% to find the value needed.
   b) Question: A property purchased three years ago for $200,000 has appreciated 16\%. What is its current value?

      \[
      \text{Per} = 100\% + 16\% = \underline{\text{______}} \\
      B = \$200,000 \\
      A = \text{Per} \times B = 1.16 \times \$200,000 = \underline{\text{______}}
      \]
C. Income approach

1. Key point
   a) The income approach is used for properties that ________________________________, such as an apartment building, shopping center, or office building.

2. Investment properties
   a) Real estate investors buy for the income the property produces.
   b) Investors determine what they will pay based on a rate of return or _____________________________.
   c) The capitalization rate (or cap rate) for a property type in a given area can be determined by using past sales. This allows the appraiser to estimate the present value of a property that has not yet closed.

3. Capitalization
   a) Process of converting estimated future income into _________________________________.
   b) Calculation of future income is based on a property’s annual net operating income (NOI)

<table>
<thead>
<tr>
<th>Potential annual gross income</th>
<th>$66,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>– Bad debt (2%)</td>
<td>– 1,320</td>
</tr>
<tr>
<td>– Vacancy (3%)</td>
<td>– 1,980</td>
</tr>
<tr>
<td>Effective gross income</td>
<td>$62,700</td>
</tr>
<tr>
<td>– Operating expenses</td>
<td>– 29,400</td>
</tr>
<tr>
<td>= Net operating income</td>
<td>$33,300</td>
</tr>
</tbody>
</table>

c) Cash flow = I (net operating income) minus debt service

d) Capitalization math

\[
\text{income = rate \times value}
\]

\[
I = \text{net operating income (NOI)}
\]

\[
R = \text{capitalization rate (investor rate of return, also affected by market forces)}
\]

\[
V = \text{value (what can be paid for a property to get the expected return)}
\]

Three relationships:

\[
I = RV
\]

\[
R = \frac{I}{V}
\]

\[
V = \frac{I}{R}
\]

(1) Example 1: If a property’s annual net income is $10,000 and the investor desires a return of 10%, what would the investor be willing to pay?

\[
I = 10,000
\]

\[
R = 10\%
\]

\[
V = \frac{I}{R}
\]

\[
$10,000 \div 0.10 (10\%) = \text{________}
\]

The investor can pay $100,000 for a property earning $10,000 net and realize the desired yield of 10%.
(2) Example 2: An investor offers $400,000 for a property and expects to earn a rate of return of 6%. How much is the net operating income?

Value = $400,000
Rate = 6% (0.06)

\[ I = 400,000 \times 0.06 = \] __________

(3) Example 3: The net operating income for a property is $18,000. An investor offered $300,000 for it. What is the rate of return?

\[ I = 18,000 + 300,000 = \] __________

4. Gross rent multiplier

a) Gross rent multiplier is a simplified alternative to capitalization that takes into account gross income but not vacancies, bad debts, or expenses. It is used primarily for single-family rental homes.

(1) Example

- Comp. 1: $100,000 price ÷ $830 gross monthly rent = 120 GRM
- Comp. 2: $120,000 price ÷ $1,000 gross monthly rent = 120 GRM
- Comp. 3: $115,000 price ÷ $960 gross monthly rent = 120 GRM
- Comp. 4: $105,000 price ÷ $865 gross monthly rent = 121 GRM

(a) These calculations indicate that the gross monthly rent multiplier in this neighborhood is approximately 120.

(b) If the subject property has a gross monthly income of $1,000, the estimated value will be $120,000 ($1,000 × 120 = $120,000).

![Gross Rent Multiplier Diagram]

Value = Annual or monthly gross rent multiplier multiplied by annual or monthly rent

Three relationships:

- value = GRM × rent
- rent = value ÷ GRM
- GRM = value ÷ rent

b) Formulas (remember, income must match the multiplier)

(1) Annual gross rent multiplier × annual potential gross rent = value

or

Monthly gross rent multiplier × monthly potential gross rent = value

(2) Example: The monthly gross rent multiplier in the area is 120. If the annual rent is $12,000, what is the value?

\[ \text{monthly gross rent multiplier} \times \text{monthly gross rent} = \text{value} \]

\[ 120 \times (12,000 ÷ 12) = 120 \times 1,000 = 120,000 \]
V. RECONCILIATION

A. Key points

1. The appraiser reconciles (correlates) the three approaches to value (sales comparison/market data, cost, and income).

2. Each approach is weighted and used to determine a subject’s estimated value.

3. The appraiser considers all three approaches but gives the most weight to the approach that is the most appropriate for the property type.
   a) For a single-family property, the appraiser would give the most weight to the sales comparison approach.
   b) For a unique property like a school, the appraiser would give the most weight to the cost approach.
   c) For an income-producing property like an office building or shopping center, the appraiser would give the most weight to the income approach.
UNIT 6 GLOSSARY REVIEW

(capitalization) cost approach  depreciation  economic obsolescence  effective age  estimate
functional obsolescence  income approach  market data approach  net operating income  physical deterioration  reconciliation
replacement cost  reproduction cost  sales comparison  substitution  value

1. The process of converting a future income stream into an expression of present value is  
2. The cost of replacing an improvement with another of similar quality but not an exact replica is  
3. Loss in value due to causes external to the property is  
4. A method of valuing a property by comparing the subject property to similar properties that have recently sold is the  
5. Demand, utility, scarcity, and transferability are essential elements of  
6. An appraisal is an  of value.
7. To obtain the value using the capitalization approach, an appraiser would divide the  by the capitalization rate.
8. The market data approach is based on the principle of  
9. An appraiser calculates accrued depreciation in the  
10. When an appraiser determines the accrued depreciation, outdated plumbing fixtures would be considered  
11. An appraiser estimating operating expenses is using the  
12. The market data approach is also known as  
13. The step in which the appraiser weighs all approaches to determine a final value is  
14. An appraiser determining the value of a shopping center would use the  
15. The best approach to determine the value of a library would be the  
UNIT 6 QUIZ

1. Which approach should be used to appraise a 12-year-old, single-family home in a residential neighborhood?
   a. Sales comparison approach
   b. Cost approach
   c. Income approach
   d. Gross rent multiplier method

2. A property that has a net operating income of $18,000 and a value of $200,000 would have a rate of return (capitalization rate) of
   a. 6%.
   b. 8%.
   c. 9%.
   d. 10%.

3. Which appraisal method considers the cost to build a replacement for the improvements?
   a. Income approach
   b. Market data approach
   c. Cost approach
   d. Comparison approach

4. A five-bedroom home with one bath is an example of
   a. functional obsolescence.
   b. physical deterioration.
   c. economic obsolescence.
   d. gross rent adjustment.

5. All of these are examples of obsolescence EXCEPT
   a. neighborhood decline.
   b. an impractical floor plan.
   c. a two-story home with one bathroom located in the basement.
   d. a leaky roof.

6. Reproduction cost is defined as
   a. the current cost to rebuild with the same or highly similar materials.
   b. replacing an improvement with another that has the same utility.
   c. the cost determined by the capitalization rate and value.
   d. none of these.

7. An appraiser would MOST likely rely on the cost approach when appraising a
   a. single-family home.
   b. duplex.
   c. church.
   d. town house.

8. Income capitalization is MOST likely to be associated with the appraisal of
   a. a condominium project.
   b. a single-family home.
   c. an apartment building.
   d. a town house.

9. In the market data approach, adjustments to the comparables would be made for all of these EXCEPT
   a. number of baths.
   b. square footage.
   c. time of sale.
   d. capitalization.

10. The purpose of capitalization is to estimate
    a. present value based on current or expected income.
    b. future value based on current gross income.
    c. present value by multiplying net income by the rent multiplier.
    d. operating expenses based on the highest and best use.

11. Which principle of value underlies all three approaches to value?
    a. Change
    b. Substitution
    c. Regression
    d. Aggression

12. A building valued at $195,000 has a gross income of $27,000 and expenses of 45%. What is its cap rate?
    a. 6.2%
    b. 7.6%
    c. 13.8%
    d. 45%
13. While writing an appraisal report based on the cost approach, an appraiser referred to “replacement cost new.” This is the present cost of replacing the subject improvement with another that
   a. has the same function and utility.
   b. uses the same or highly similar materials.
   c. was built on a similar lot.
   d. was built in the same year as the subject property.

14. A salesperson has done a BPO for a bank. The salesperson must make sure that the bank understands
   a. the opinion is not an appraisal.
   b. that because the salesperson cannot be paid for the opinion the bank is obligated to list the property with the salesperson.
   c. the opinion is comparable in scope to an appraisal.
   d. the opinion is equal to an appraisal and the salesperson will be paid the same as an appraiser.

15. A broker performed a competitive market analysis and determined that the comparable homes are in better overall condition than the seller's property. What adjustments should be made?
   a. The sales prices of the comparables should be adjusted upward.
   b. The sales price of the subject should be adjusted upward.
   c. The sales prices of the comparables should be adjusted downward.
   d. The listing price of the subject should be the assessed value.

16. Which appraisal method depends on an accurate estimate of the value of the accrued depreciation?
   a. Reproduction approach
   b. Market data approach
   c. Cost approach
   d. Income approach

17. Which of the following is used to determine the gross rent multiplier?
   a. Income divided by rent received
   b. Adjustment to comparable sales
   c. Sales price and rental rates
   d. Estimated replacement cost minus depreciation

18. All of the following are essential elements of value EXCEPT
   a. utility.
   b. scarcity.
   c. demand.
   d. profitability.

19. If the demand for a particular housing style increases, the principle of supply and demand indicates that
   a. the price will likely decrease.
   b. the supply will immediately increase.
   c. the price will likely increase.
   d. affordability will prohibit any change in price.

20. When an appraiser uses more than one method to estimate value, the process used to arrive at the single final estimate is called
   a. averaging.
   b. regression.
   c. reconciliation.
   d. capitalization.

21. Progression and regression are part of which principle of value?
   a. Conformity
   b. Change
   c. Substitution
   d. Contribution

22. An appraiser estimating depreciation is using which approach to value?
   a. Cost
   b. Income
   c. Market data
   d. Capitalization

23. An appraiser reviewing comparables is using which approach to value?
   a. Cost
   b. Income
   c. Sales comparison
   d. Gross rent multiplier
24. The broker determined that if the seller will spend $4,000 in upgrades, the value of the property will increase by $6,000. Which principle of value did the broker use to make this determination?
   a. Conformity
   b. Change
   c. Substitution
   d. Contribution

25. Market value is the
   a. same as market price.
   b. actual closed price.
   c. market price minus sales price.
   d. most probable price.

26. The monthly GRM is 120. The annual income is $24,000. What is the value of the property?
   a. $24,000
   b. $240,000
   c. $288,000
   d. $2,888,000

27. The formula used in the cost approach is
   a. land minus depreciation plus cost to build new.
   b. cost to build new minus land plus depreciation.
   c. cost to build new minus depreciation plus land.
   d. sales price minus land and cost to build new plus depreciation.

28. An appraisal is used to determine which of the following?
   a. Probable sales price
   b. Assessed value
   c. List price
   d. Market price

29. The subject property has five bedrooms and three and a half bathrooms. Which of the following comparables would have to make a deduction from the sales price?
   a. Comparable 1 has four bedrooms and three bathrooms.
   b. Comparable 2 has no air-conditioning or fireplace.
   c. Comparable 3 is in a better condition.
   d. Comparable 4 has the same square footage but no patio.
1. a The sales comparison approach is the most important approach for the appraisal of single-family residences.
2. c The net operating income ($18,000) divided by the value ($200,000) equals a rate of return of 0.09 or 9%.
3. c The cost approach estimates the replacement cost, subtracts depreciation from all sources, and adds the value of the land to arrive at an estimate of value.
4. a Inadequate design or equipment is functional obsolescence.
5. d A leaky roof is an example of physical deterioration (not functional or economic obsolescence).
6. a Reproduction cost is the cost of building a replica.
7. c The cost approach is most often used for unique or special-purpose properties (e.g., churches and schools).
8. c Income capitalization (the income approach to value) is used to appraise income-producing properties (e.g., office buildings, shopping centers, and apartment buildings).
9. d Capitalization is part of the income approach, which does not include adjustments to comparables.
10. a Capitalization is the process by which present value is estimated based on expected income.
11. b The principle of substitution states that buyers would not pay more for a property than they would have to pay to acquire a similar substitute property.
12. b $27,000 (gross income) × 45% or 0.45 (expenses) = $12,150 expenses
   gross income – expenses = net income
   $27,000 – $12,150 = $14,850
   net income + property value = cap rate
   $14,850 ÷ $195,000 = 0.076 or 7.6% cap rate
13. a Replacement cost new is the present cost of replacing the subject improvement with another having the same function and utility, using current construction standards and costs.
14. a A salesperson completing a BPO may be paid but must make sure the receiver (in this case, the bank) knows the opinion is not an appraisal.
15. c Adjustments are always made to the comparables. If the comparable is superior to the subject, the sales price of the comparable is adjusted downward.
16. c In the cost approach, the appraiser must estimate the accrued depreciation to be subtracted from the replacement cost of the improvements.
17. c Divide the sales price by the rental rates to determine the gross rent multiplier.
18. d The essential elements of value are demand, utility, scarcity, and transferability (DUST).
19. c When demand increases, it causes prices to increase.
20. c In reconciliation, the appraiser uses professional judgment to weigh the alternative values and estimate the best value for the subject property.
21. a Conformity uses progression and regression.
22. a Depreciation is used in the cost approach to value.
23. c Comparables are used in the market data or sales comparison approach.
24. d Contribution through increasing and decreasing returns will reveal whether upgrades will add more value than they cost.
25. d Market value is the most probable price a property will bring. Market price is the actual sales price.
26. b To determine value, the monthly GRM is multiplied by the income, which must be converted to a monthly figure: 120 × ($24,000 ÷ 12) 120 × $2,000 = $240,000.
27. c The formula used in the cost approach is the cost to build new minus depreciation plus land.
28. a An appraisal estimates market value, which is the probable sales price a property will bring in an open market.
29. c The condition of comparable 3 is better than the subject, so it needs to be adjusted downward to make it similar to the subject. The other comparables would need to be adjusted upward.
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- **demonstrate** how to use a loan factors chart, loan payment chart, and circle formula for interest;
- **differentiate** between commonly used financing documents and explain their special provisions;
- **list** the types of foreclosures and summarize a typical foreclosure process; and
- **list** the types of loans and explain when they are typically used.

Study Plan

**Before Class:**
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP workbook reading guide.
Read the Math Refresher and Unit 7 Key Points.

**After Class:**
Complete the Glossary Review.
Complete the Review Exam.
A promissory note is a written promise to repay a debt. A promissory note for a real estate loan is almost always accompanied by a mortgage or deed of trust on the property.

Loans to buy real estate are generally secured by either a mortgage or a deed of trust, depending on state laws. Either of these instruments creates a lien against the property, allowing the lender to foreclose in case the loan is not paid as promised.

A deed of trust or a mortgage is a security agreement (contract) that makes real property collateral for a loan. It creates a lien on the property. If the borrower doesn’t repay as agreed in the promissory note, the security agreement gives the lender the right to foreclose on the property.

When a mortgage is paid in full, a satisfaction of mortgage is used to release the mortgage lien. A reconveyance deed is used to release a deed of trust.

The loan-to-value ratio (LTV) that a lender applies determines the maximum loan amount for a transaction. The loan-to-value ratio is based on the appraised value or sales price of the property, whichever is less.

A lender charges discount points to increase the yield on the loan. The points are paid at closing by either the buyer or the seller. One point is 1% of the loan amount.

Equity is the difference between the value of a property today and the debt against the property today.

Most foreclosure laws are created at the state level, but they all share some common concepts. The lender files a notice of default and then the borrower is given a period of time to repay the debt. If the borrower cannot clear the default, the property goes to sale. The sale removes all liens against the property. The winner of the bid then has the right, based on state laws, to obtain title to the property.

A straight or term note is a loan in which interest-only payments are made during the term, with the full amount of the principal due at the end in a balloon payment. With an amortized note, payments include both principal and interest. If a note is fully amortized, the entire principal amount and all of the interest will be paid off within the agreed loan period.

With a fully amortized loan, the interest rate and the amount of the payment remain the same throughout the term of the loan. But there are a variety of alternative repayment plans, such as adjustable-rate mortgages (ARMs).

In some transactions, a seller will participate in providing financing to the buyer. This seller carryback loan may be a second priority loan for part of the purchase price. Loans of this type are sometimes referred to as a purchase money mortgage from the seller.

An alternative form of seller financing, usually for the entire purchase price, is an installment land contract or contract for deed. In this type of financing, the seller (vendor) retains legal title until the entire amount is paid and delivers a deed at the end of the agreed payment. The buyer (vendee) receives equitable title and possession of the property while they pay the loan.

Leverage is using someone else’s money (borrowed money) to purchase real estate. The higher the debt, the higher the leverage, the higher the risk of default, and the lower the down payment.
A. Loan factors (amortization) chart

1. Simple charts are available to estimate payments for fully amortized loans over various terms and at different interest rates. These charts show the monthly payment per $1,000 of debt for each combination of the interest rate and loan term. These represent the payment to principal and interest and do not take into account property taxes, insurance, homeowner fees, or any other ongoing property expense (see Figure 7.1).

<table>
<thead>
<tr>
<th>Interest</th>
<th>15 years</th>
<th>20 years</th>
<th>25 years</th>
<th>30 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.00%</td>
<td>8.4386</td>
<td>7.1643</td>
<td>6.4430</td>
<td>5.9955</td>
</tr>
<tr>
<td>6.50%</td>
<td>8.7111</td>
<td>7.4557</td>
<td>6.7521</td>
<td>6.3207</td>
</tr>
<tr>
<td>7.00%</td>
<td>8.9883</td>
<td>7.7530</td>
<td>7.0678</td>
<td>6.6530</td>
</tr>
<tr>
<td>7.50%</td>
<td>9.2701</td>
<td>8.0559</td>
<td>7.3899</td>
<td>6.9921</td>
</tr>
</tbody>
</table>

**FIGURE 7.1**

Loan Factors per $1,000 for a Fully Amortized Loan

a) To use the chart, calculate how many thousands of dollars are in the loan (loan amount ÷ $1,000) and multiply by the factor for the loan interest rate and term.

2. Practice question

a) A buyer is obtaining a $165,000 loan at a 7% interest rate. If the buyer can afford a payment of $1,280 for principal and interest, what loan term will allow the buyer to pay off the loan in the shortest amount of time?

(1) Solution: The loan will be 165 thousands. Using the 7% row, multiply the factor under each loan term by 165 to see if the payment is affordable. For example, try 15 years: $165 \times 8.9883 = $1,483.07; this is too high, so repeat until you calculate a payment of $1,280 or less. The answer is 20 years ($165 \times 7.7530 = $1,279.25).

B. Loan payment chart

1. A loan payment chart is similar to a loan factors chart, but it is used to calculate payments for a specific loan amount at a range of interest rates and loan terms. The dollar amounts in the chart are the actual payments. Each chart relates to a specific loan amount listed in the chart title (see Figure 7.2).

<table>
<thead>
<tr>
<th>Interest</th>
<th>10 years</th>
<th>15 years</th>
<th>20 years</th>
<th>30 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.00%</td>
<td>$1,750.08</td>
<td>$1,304.81</td>
<td>$1,088.93</td>
<td>$885.76</td>
</tr>
<tr>
<td>5.25%</td>
<td>$1,770.31</td>
<td>$1,326.40</td>
<td>$1,111.84</td>
<td>$911.14</td>
</tr>
<tr>
<td>5.50%</td>
<td>$1,790.68</td>
<td>$1,348.19</td>
<td>$1,135.01</td>
<td>$936.85</td>
</tr>
<tr>
<td>5.75%</td>
<td>$1,811.19</td>
<td>$1,370.18</td>
<td>$1,158.44</td>
<td>$962.90</td>
</tr>
<tr>
<td>6.00%</td>
<td>$1,831.84</td>
<td>$1,392.36</td>
<td>$1,182.11</td>
<td>$989.26</td>
</tr>
<tr>
<td>6.25%</td>
<td>$1,852.62</td>
<td>$1,414.75</td>
<td>$1,206.03</td>
<td>$1,015.93</td>
</tr>
<tr>
<td>6.50%</td>
<td>$1,873.54</td>
<td>$1,437.33</td>
<td>$1,230.20</td>
<td>$1,042.91</td>
</tr>
<tr>
<td>6.75%</td>
<td>$1,894.60</td>
<td>$1,460.10</td>
<td>$1,254.60</td>
<td>$1,070.19</td>
</tr>
<tr>
<td>7.00%</td>
<td>$1,915.79</td>
<td>$1,483.07</td>
<td>$1,279.24</td>
<td>$1,097.75</td>
</tr>
</tbody>
</table>

**FIGURE 7.2**

Monthly Payments for a $165,000 Loan

a) This type of chart can help match a loan qualification with the appropriate loan term and interest rate.
2. Practice questions

a) A couple who earns $4,950 per month after taxes wants to have a mortgage payment that is no more than 25% of their monthly earnings. Using the chart in Figure 7.2, determine which interest rate and term will give the couple the payment closest to what they are seeking.

(1) Calculate their maximum monthly payment: $4,950 \times 25\% = \underline{1,237.50}.

(2) Find the payment closest to their maximum payment without going over it. They can afford the loan at \underline{6.5\%} for \underline{20} years.

(3) Solution: (1) $4,950 \times 25\% = $1,237.50; (2) a loan at 6.5\% over 20 years has a payment of $1,230.20.

b) A buyer purchased a home for $150,000 and applied for a 90% conventional loan at 8\% interest with a 30-year term. The amortization factor is 7.34. What is the buyer's monthly payment of principal and interest?

(1) Solution: $150,000 \times 0.90 = $135,000 loan

\[
\text{(loan} \div 1,000) \times \text{amortization factor} = \text{payment}
\]

\[
\left(\frac{135,000}{1,000}\right) \times 7.34 = $990.90 \text{ payment}
\]

C. Interest calculation

1. When lenders loan money (principal), they demand an annual rate of return (interest) on the amount that is still owed. Traditionally, borrowers make a monthly payment on their mortgage that covers the interest and some principal (except for interest-only loans). See Figure 7.3.

**Figure 7.3**

Circle Formula for Interest

2. Question 1: A borrower obtains a $300,000 loan at 6\% interest. What is the borrower's annual interest amount?

\[
$300,000 \times 6\% \times 0.06 = \underline{18,000}
\]

3. Question 2: A borrower obtains a $300,000 loan at 6\% interest. What is the borrower’s interest for the first month?

\[
\left[\frac{300,000 \times 6\%}{0.06}\right] \div 12
\]

\[
$18,000 \div 12 = \underline{1,500}
\]

4. Question 3: If the principal is $300,000, the interest rate is 6\%, and the borrower’s monthly payment is $1,650, how much of the payment is applied to the principal?

\[
(300,000 \times 6\%) \div 12 = $18,000 \div 12 = $1,500
\]

\[
$1,650 - $1,500 = \underline{150}
\]

Solutions:
2. $18,000
3. $1,500
4. $150
I. FINANCING DOCUMENTS

A. Title theory versus lien theory

1. In title theory states, the mortgagor actually gives legal title to the mortgagee (or some other designated individual) and retains equitable title. Legal title is returned to the mortgagor only when the debt is paid in full (or some other obligation is performed). In theory, the lender actually owns the property until the debt is paid.

2. In lien theory states, the mortgagor retains both legal and equitable title. The mortgagee simply has a lien on the property as security for the mortgage debt.
   a) The mortgage or deed of trust is nothing more than collateral for the loan.

3. Whether a mortgage or deed of trust is used, the function is the same: to act as security for the promissory note by pledging the real estate property as collateral for the debt.

4. States using deeds of trust often use nonjudicial foreclosure (also known as power of sale); those using mortgages use either nonjudicial or a judicial foreclosure process.
B. Promissory note

**FIGURE 7.5**

Promissory Note

<table>
<thead>
<tr>
<th>Promissory Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date and address</td>
</tr>
<tr>
<td>(Property Address)</td>
</tr>
<tr>
<td>amount of debt</td>
</tr>
<tr>
<td>Lender Name</td>
</tr>
<tr>
<td>Assignment clause</td>
</tr>
<tr>
<td>Interest rate and amortization</td>
</tr>
<tr>
<td>Terms of repayment</td>
</tr>
<tr>
<td>Balloon clause</td>
</tr>
<tr>
<td>No prepayment penalty clause</td>
</tr>
<tr>
<td>Late charge</td>
</tr>
<tr>
<td>Standard allocation</td>
</tr>
<tr>
<td>Security instrument</td>
</tr>
</tbody>
</table>
1. Legal instrument that ____________________________ that is secured by the mortgage or deed of trust

2. Held by lender until loan is fully repaid

3. Key elements
   a) Personal promise of borrower to repay a fixed amount
   b) Terms of repayment
   c) Signature of borrower; lender does not sign

4. Special provisions
   a) Acceleration clause
      (1) If borrower ____________________________, lender can demand immediate payment of ____________________________
   b) Promissory note alone does not create a lien on the property
   c) Most real estate notes are negotiable and transferable, which allows them to be sold

C. Mortgage or deed of trust (security instruments)

1. Instruments that pledge (hypothecate) property as security for a debt

2. Mortgage or deed of trust creates a lien
   a) Creates payment obligation to pay off principal and interest
   b) Interest on the majority of home loans is ____________, not compounded

3. Allows for foreclosure if borrower defaults on the note

4. Mortgage: two-party instrument
   a) Borrower is the ____________________________ who gives the mortgage to the lender
   b) Lender is the ____________________________ (see Figure 7.6)

5. Deed of trust: three-party instrument (see Figure 7.7)
   a) Borrower is the trustor
   b) Lender is the ____________________________ (benefits from the trust)
   c) Trustee—in some states, a public official
D. **Provisions of a mortgage/deed of trust**

1. Defines the rights and obligations

2. Acceleration clause—lender may demand full payment in case of default

3. Defeasance clause—when debt is paid (mortgage/deed of trust), lien must be removed
   a) Mortgagee provides “satisfaction.”
   b) Trustee provides “deed of reconveyance.”
   c) Satisfaction or reconveyance deed proves payments are in full and are recorded by borrower.

4. ________________________________—also called alienation clause
   a) Provides that when the property is ________________, the lender may demand immediate repayment of entire debt
   b) Requires lender consent for assumption of the loan

5. Power of sale clause—optional provision in mortgage if state allows; standard in deeds of trust
   a) Gives the trustee/mortgagee the power to foreclose without going to court (nonjudicial)

E. **Reasons for loan acceleration and foreclosure**

1. Nonpayment of principal and interest

2. Nonpayment of taxes

3. Removal of improvements without lender's permission

4. Insurance coverage lapse

5. ________________________________—would include deferred maintenance that lowers value below what is owed

6. Alienation without consent (if there is a due-on-sale clause)
II. **MISCELLANEOUS MORTGAGE TERMS**

**A. Loan-to-value ratio (LTV)**

1. Also called a mortgage ratio
   a) Determines how much money can be borrowed and if private mortgage insurance will be needed
2. Maximum percentage of value that the lender will loan to the borrower in a particular transaction
3. Sales price or appraised value (whichever is lower)

**B. Equity**

1. Market value today
   \[ \text{Equity} \]

**C. Leverage**

1. Refers to the effect of using borrowed money to finance an investment
   a) The higher the loan-to-value ratio (the more money borrowed), the higher the leverage.
   b) The disadvantage of high leverage is the greater risk of default on the loan (lower equity equals higher risk).
   c) The advantage of leverage is being able to control a large asset with little cash investment.

**D. Discount points**

1. One point = 1% of the loan amount
2. Paid to the lender to lower the interest rate on the loan
3. Lender charges points to 

4. Paid by buyer or seller at closing

**E. Loan origination fee**

1. A charge by the lender to process and issue a loan

**F. Usury**

1. Usury is charging an interest rate in excess of what is permitted by law.
2. State laws determine the maximum interest rate limits and the type of loans affected by usury law.

III. **FORECLOSURE—GOVERNED BY STATE LAWS**

**A. Key points**

1. Foreclosure is a procedure whereby title to property used as security for a debt is taken by a creditor/lender and

   a) The foreclosure process removes 

      from the property.
2. The types of foreclosures include the following:
   a) Foreclosure by judicial (legal) action
   b) Nonjudicial foreclosure

B. Judicial foreclosure
   1. Lawsuit to obtain the power to sell from a court
   2. Lis pendens is filed with county recorder

C. Nonjudicial foreclosure
   1. Trustees and mortgagees may be given the authority to hold a foreclosure auction without going to court.
   2. The mortgage or deed of trust must have a power of sale clause.

D. Foreclosure sale process (for most states)
   1. Equitable redemption period: right to stop foreclosure
      a) The borrower cures by paying ________________________________________, plus interest and penalties.
      b) The time period from when the lender declares default until the sale is set by state law.
   2. Foreclosure sale
      a) Lender sends demand to foreclose
      b) Property sold to highest bidder at public auction
   3. Sale date starts the statutory redemption period
      a) The borrower must bring full principal, interest, and fees to redeem.
      b) At the end of the statutory redemption period, the highest bidder receives the deed to the property.
   4. Lender sells the real estate owned (REO) property after statutory redemption period to satisfy the debt
      a) Excess sale proceeds belong to the borrower/trustor.
      b) Insufficient sale proceeds may result in a ___________________________________________ judgment to the lender.

IV. DEED IN LIEU OF FORECLOSURE AND SHORT SALE

A. Deed in lieu of foreclosure (alternative to foreclosure)
   1. The borrower deeds to the lender to avoid foreclosure.
   2. __________________________________________________________.
   3. The lender may not be willing to accept.
   4. If the property has junior liens, the lender takes title subject to these liens.
B. Short sale

1. A short sale occurs when the borrower needs to sell the property and the market value of the collateral property is insufficient to satisfy the loan balance.

2. The broker lists the property for sale for less than what is owed on the loan.

3. Once an offer is accepted, the lender may or may not agree to accept the reduced (deficient) price.

4. The lender may require the seller to pay any deficiency and the seller may have tax consequences.

V. METHODS OF PRINCIPAL AND INTEREST (DEBT SERVICE) PAYMENT

A. Term (straight) loan

1. ______________ payments until maturity or at end of term

2. Entire principal paid back in one lump sum ______________ payment

B. Partially amortized (balloon) loan

1. Equal payments of principal and interest

2. Lump sum balloon payment

C. Fully amortized loan—fixed rate

1. Equal consecutive installments of principal and interest

2. Balance decreases with each payment

3. Balance becomes zero at maturity

<table>
<thead>
<tr>
<th>Loan Types</th>
<th>Payment</th>
<th>Balloon</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term loan</td>
<td>Small: interest only</td>
<td>Large: full principal</td>
<td>Short: 6 months to 2 years</td>
</tr>
<tr>
<td>Partially amortized</td>
<td>Bigger: principal and interest</td>
<td>Medium: balance of principal</td>
<td>Relatively short: 1 to 5 years</td>
</tr>
<tr>
<td>Fully amortized</td>
<td>Large: enough to pay in full</td>
<td>None</td>
<td>Larger: 15 to 30 years</td>
</tr>
</tbody>
</table>

D. Adjustable-rate mortgage (ARM)

1. Interest rate subject to change based on economic index or indicator

2. Index + margin = rate

3. May include annual adjustment caps and/or lifetime rate caps

E. Budget mortgage

1. Payments include debt service plus tax and insurance escrow

2. ____________: Principal, interest, taxes, and insurance
F. Package mortgage
   1. Real property plus personal property
      a) Example: furnished condominium

G. Blanket mortgage
   1. Typically used by developers
   2. More than one parcel pledged
   3. Partial release clause allows individual parcels to be released from lien as balance is paid down
   4. Payment for releases are not necessarily in equal amounts (i.e., first property sold will have a larger payment amount, increasing owner’s equity)

H. Construction mortgage
   1. Interim financing made available in installments (obligatory advances) as improvements are completed
   2. Typically adjustable-rate/short-term loans
   3. Lender may require a commitment for “take out”

I. Reverse mortgage—for seniors (was called a reverse annuity)
   1. Lender pays borrower monthly payments of principal with each disbursement
   2. Allows seniors to tap into equity in their homes without selling
   3. Repaid upon death of mortgagor, sale of property, or when the balance reaches the maximum limit

J. Home equity loan
   1. Truth in Lending Act (Regulation Z) requires all home equity loans to have a
   2. Owner borrows against equity in home
      a) Borrower receives a check for the full amount borrowed
   3. Home equity line of credit (HELOC)
      a) Allows the borrower to obtain further advances at a later date
      b) Future advances are limited to the difference between the original loan amount and the current amount owed

VI. SUBPRIME AND PREDATORY LENDING
A. Subprime loans
   1. In subprime loans, a higher-than-prime rate is charged because the borrower and/or property used as security is a
      (e.g., prime rate might be 6%, while subprime is 8%).
2. Subprime loans often include flexible-rate loans (i.e., ARMs) that adjust beyond the borrower's ability to pay.
   a) The borrower qualifies at a lower rate and once rate adjusts up, the borrower is at risk of foreclosure.
   b) Mortgage brokers and bankers receive higher fees on these loans.
3. Subprime loans were packaged with prime loans and sold to investors on the secondary market.

B. Predatory lending
1. Predatory lending is an umbrella term for unfair or illegal lending practices.
   a) Most often, this type of lending occurred in the subprime market.
2. Groups that are targeted include the elderly, minorities, those who are less educated, and persons who do not speak English as their first language.
3. Predatory practices include the following:
   a) Making loans to borrowers who have no ability to repay
   b) Urging borrowers to refinance repeatedly, when it is not in the best interest of the borrower
   c) Originating loans with high prepayment penalties
   d) Using one set of terms at application and pressing the borrower to accept higher terms at closing
   e) Offering loans with low monthly payments and a high balloon payment at the end (e.g., an interest-only loan for 30 years)
   f) Offering only subprime rates to borrowers who qualify for prime rates and terms
4. Many states now have predatory lending laws and require lenders and originators to be licensed.
5. Subprime loans are often coupled with “down payment assistance” (second mortgage) so borrowers did not make down payments on their loan, which made them more likely to default.
   a) Example: Subprime loan: 80% LTV
      (1) Down payment (second mortgage): 20% LTV
      (2) Total loan: 100% with no money from the borrower

VII. SELLER FINANCING

A. Purchase money mortgage
   1. Also called a seller-carry second or “seller carry back”
   2. Usually uses a promissory note and deed of trust or mortgage; title transfers to buyer, and seller “takes back” a lien at closing; seller becomes the lender

B. Contract for deed
   1. A contract for deed is also known as a ______________ contract or an __________________ contract.
2. The purchase price is paid in installments to the seller, and the seller delivers a deed when the final payment is made.

   a) It is most beneficial to the seller because the seller holds title and may benefit if the buyer defaults.

C. Licensee’s role

   1. With seller financing, real estate professionals should make sure both the seller and the buyer understand the risks that may be involved.
1. The borrower’s right to cure the default and stop the foreclosure sale is _________________.

2. A mortgage pledging personal property, as well as real property, as security for a debt is a _________________.

3. The clause that appears in both the note and the mortgage that allows the lender to demand immediate payment of the entire debt if the borrower defaults is an _________________.

4. A loan that is repaid in one single lump sum at the end of its life is called a straight loan or _________________.

5. A loan in which payments are scheduled so the entire principal balance is repaid by the maturity date is a _________________.

6. A final payment that is larger than preceding payments is a _________________.

7. A _________________ is used when more than one property is pledged as security for a single loan.

8. A mortgage given by the purchaser to the seller in partial payment for the property is a _________________.

9. The difference between a property’s market value and the debts against it is _________________.

10. A loan that allows a borrower to make smaller payments of interest and principal but has a balloon payment at the end is a _________________.

11. The clause that entitles a lender to accelerate the loan if it is assumed without the lender’s approval is an _________________.

12. Points charged by lenders are computed as a percentage of the _________________.

13. The higher the loan-to-value ratio, the higher the _________________.

14. A contract that gives a buyer the right to occupy the property now and receive a deed after payment in full of the purchase price is a _________________.

15. The mortgagee makes payments to the mortgagor in a _________________.

**UNIT 7 GLOSSARY REVIEW**

<table>
<thead>
<tr>
<th>acceleration clause</th>
<th>equitable redemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>alienation clause</td>
<td>fully amortized loan</td>
</tr>
<tr>
<td>balloon</td>
<td>leverage</td>
</tr>
<tr>
<td>blanket mortgage</td>
<td>mortgage amount</td>
</tr>
<tr>
<td>contract for deed</td>
<td>package mortgage</td>
</tr>
<tr>
<td>equity</td>
<td>partially amortized loan</td>
</tr>
<tr>
<td>purchase money</td>
<td>reverse mortgage</td>
</tr>
<tr>
<td>mortgage</td>
<td>statutory redemption</td>
</tr>
<tr>
<td>reverse mortgage</td>
<td>term loan</td>
</tr>
<tr>
<td>statutory redemption</td>
<td>variance</td>
</tr>
</tbody>
</table>
UNIT 7 QUIZ

1. Which of these terms are closest in meaning?
   a. Mortgagor, lender
   b. Mortgagee, borrower
   c. Lender, mortgagee
   d. Borrower, lender

2. An instrument used to pledge real property as security for a loan is a
   a. bill of sale.
   b. chattel agreement.
   c. promissory note.
   d. mortgage.

3. The right of the borrower to reclaim the property before the foreclosure sale is the
   a. right of first refusal.
   b. equitable redemption.
   c. riparian right.
   d. statutory right of redemption.

4. Principal is defined as the
   a. total amount paid to the lender over the life of the loan.
   b. amount each payment is first applied to.
   c. total interest and loan amount.
   d. total amount of the loan.

5. A builder purchased 50 lots that are being used as collateral in a loan that contains a partial release clause. Which type of loan did the builder obtain?
   a. Blanket loan
   b. Package loan
   c. Purchase money mortgage
   d. Reverse loan

6. Owners' equity in their property is BEST described as the
   a. difference between the current market value and the amount owed.
   b. difference between the original purchase price and the amount owed.
   c. current market value of the property.
   d. total outstanding debt against the property.

7. The disadvantage of being highly leveraged is that
   a. more down payment will be required.
   b. the borrower has more equity.
   c. borrowers are more likely to default.
   d. lower monthly payments.

8. The clause that appears in both the promissory note and the deed of trust that allows the lender to call the balance due and payable in full upon default is known as the
   a. due-on-sale clause.
   b. satisfaction clause.
   c. acceleration clause.
   d. alienation clause.

9. The figure used by the lender in determining the maximum loan amount to borrow is the
   a. purchase price or appraised value, whichever is less.
   b. appraised value minus the purchase price.
   c. purchase price.
   d. assessed value.

10. Charging an interest rate that exceeds the legal maximum ceiling is known as
    a. defeasance.
    b. usury.
    c. subordination.
    d. a violation of Regulation Z.

11. A court-supervised foreclosure resulting from a lender's lawsuit is known as
    a. cancellation.
    b. strict foreclosure.
    c. non-judicial foreclosure.
    d. judicial foreclosure.

12. The document that is recorded to give notice that a deed of trust has been paid in full is the
    a. defeasance.
    b. subordination agreement.
    c. note.
    d. reconveyance deed.
13. A form of financing in which the seller retains title but the buyer has the right of possession is
   a. a purchase money mortgage.
   b. an option.
   c. a contract for deed.
   d. a participation loan.

14. In a foreclosure, if there are insufficient proceeds, the lender may file a
   a. default judgment.
   b. deficiency judgment.
   c. declaration.
   d. right to cure.

15. The clause in a mortgage that requires the loan to be repaid when the property is sold is the
   a. acceleration clause.
   b. defeasance clause.
   c. subordination clause.
   d. alienation clause.

16. A mortgage that is tied to an economic index and may have interest rate or payment caps is
   a. a renegotiable-rate mortgage.
   b. a partially amortized mortgage.
   c. an adjustable-rate mortgage.
   d. a variable payment mortgage.

17. The document that creates security for a promissory note is a
   a. deed of trust.
   b. contract for deed.
   c. warranty deed.
   d. quitclaim deed.

18. The right of the trustor to pay off all the debt and stop the foreclosure proceedings is called
   a. statutory redemption.
   b. deed in lieu of foreclosure.
   c. redemption by action.
   d. equitable redemption.

19. Which type of loan requires interest-only payments until maturity of the principal?
   a. Blanket loan
   b. Amortized loan
   c. Term loan
   d. Partially amortized loan

20. Which of the following is TRUE of a promissory note?
   a. It is the same as a deed of trust.
   b. It is a promise to pay.
   c. It is security for the deed of trust.
   d. It is attached to a deed.

21. A document used in real estate to create a lien and give security for a note is a
   a. deed.
   b. note.
   c. mortgage.
   d. bill of sale.

22. The fee that is charged by lenders as part of their processing and is similar to a commission is called
   a. discount point.
   b. PMI.
   c. subordination.
   d. loan origination.

23. Three properties are each valued at $120,000. The first property has a loan of $95,000, the second has a loan of $60,000, and the third has no liens. The property with the highest leverage is
   a. the one with no liens.
   b. the one with the $60,000 loan.
   c. the one with the $95,000 loan.
   d. both properties with loans.

24. Which type of loan is also called an interest-only loan or term loan?
   a. Blanket
   b. Construction
   c. Straight
   d. Partially amortized

25. A buyer just found out that she cannot assume the loan on the property she is purchasing. Which clause indicated to the buyer that the loan was NOT assumable?
   a. Acceleration
   b. Alienation
   c. Defeasance
   d. Prepayment

26. Interest charged on mortgage loans is typically
   a. compound.
   b. floating.
   c. simple.
   d. discounted.
27. The acceleration clause in the note and deed of trust
   a. is used to stop assumption of the loan.
   b. allows the lender to demand full payment and changes the terms of the loan.
   c. can be used if the borrower has not maintained the property and therefore is in default.
   d. automatically accelerates the loan payments if the borrower’s payment is a few days late.

28. Which of the following statements about discount points is FALSE?
   a. Points are used to increase the yield to the lender.
   b. Each point equals 1% of the loan amount.
   c. Points are used to decrease the interest paid on a loan.
   d. Points are always paid for by the buyer.

29. When using a contract for deed, all of the following are true EXCEPT
   a. the seller holds the deed and legal title until the buyer makes the final payment.
   b. if the buyer defaults, the buyer may lose all equity and credit for payments made.
   c. this form of financing is typically most beneficial to the buyer.
   d. the buyer takes possession and is responsible for maintaining the property.

30. The formula of mortgage amount divided by the sales price or appraised value of the property determines all of these EXCEPT
   a. cost of each discount point.
   b. amount of the loan origination fee.
   c. amount of interest for each payment.
   d. amount of the down payment.
UNIT 7 QUIZ ANSWERS

1. c  The lender is the mortgagee; the borrower is the mortgagor.
2. d  The document with which real property is pledged as security or collateral for a debt is the mortgage.
3. b  The period prior to the foreclosure sale is known as the equitable redemption period.
4. d  Principal is the total or original amount of the loan. Payments are first applied to interest and then to principal.
5. a  A blanket mortgage covers two or more parcels of real estate.
6. a  Today's value minus today's debt equals today's equity.
7. c  The disadvantage to high leverage is that the borrower may default on the loan, especially if market values start to drop.
8. c  The acceleration clause allows the lender to "call the note" upon default.
9. a  The loan-to-value ratio is based on the purchase price or the appraised value, whichever is less.
10. b  A loan in which the rate exceeds the legal maximum ceiling is said to be usurious.
11. d  If a lender files a lawsuit to have a mortgage foreclosed under the supervision of the court, it is a judicial foreclosure.
12. d  The document is called a reconveyance deed of trust which will release the lien that was created by the original deed of trust.
13. c  The seller retains legal title under a contract for deed; the buyer has equitable title.
14. b  If the sale proceeds are insufficient to satisfy the debt, the lender may be able to claim a deficiency judgment.
15. d  The alienation clause is also known as the due-on-sale clause.
16. c  The interest rate on an adjustable-rate mortgage is subject to change based on increases or decreases in a specific economic index.
17. a  A deed of trust (trust deed) is a financing instrument used in some states. It works in much the same way as a mortgage.
18. d  Equitable redemption is the right to pay off the loan before the foreclosure sale; statutory redemption is the right to redeem the property after the sale.
19. c  A term or straight loan requires interest-only payments until maturity, at which time the entire principal balance must be paid in full.
20. b  The note establishes a promise to repay a debt.
21. c  A mortgage pledges real property to secure a debt (a loan), whereas a deed transfers title to real property from one owner to another.
22. d  The loan origination fee is similar to the lender's commission.
23. c  The property with the highest loan amount of $95,000 is the most highly leveraged (has used the highest amount of borrowed money).
24. c  Another name for a term loan or interest-only loan is a straight loan.
25. b  The alienation (due-on-sale) clause will determine whether a loan is assumable.
26. c  Simple interest is charged on most mortgage loans, not compound, floating, or discount interest.
27. c  The acceleration clause may be used any time the borrower is in default, such as not maintaining the property and committing waste. The acceleration clause does not allow the lender to change the terms of the loan or arbitrarily call the note due.
28. d  Discount points can be paid by the buyer or the seller, based on tradition or the terms of the purchase agreement.
29. c  Contract for deed or installment land contracts are typically most advantageous to the seller because the buyer does not have title to the property, but is in possession and must maintain it. Also, if the buyer defaults, state laws tend to favor the seller and buyers can lose their rights to any equity earned.
30. c  The formula that is used to determine the LTV will then determine the cost of each discount point, loan origination fee, and amount of down payment, but not the interest rate charged.
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- distinguish between conventional, government, and private loan programs available for real estate financing;
- discuss the sources of real estate funding and the government laws that regulate lending;
- explain the tax implications inherent in real property investments;
- describe the federal laws that protect Americans from unfair housing practices; and
- explain the importance of real estate licensees understanding and complying with standards of ethical practice.

Study Plan

Before Class:

Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.

Read the Unit 8 Key Points.

After Class:

Complete the Glossary Review.

Complete the Review Exam.
A conventional loan is a mortgage loan that is not insured or guaranteed by a government agency. Conventional loans may require private mortgage insurance (PMI), depending on the loan to value (LTV).

The Federal Housing Administration (FHA) is part of the Department of Housing and Urban Development (HUD). It provides home mortgage insurance, insuring approved lenders against losses resulting from default and foreclosure on FHA-insured loans.

The Department of Veterans Affairs (VA) guarantees repayment of certain residential loans made to eligible veterans. Eligibility for VA loans is based on the length of service in the U.S. armed forces.

The primary or local market is the ground-level money market, where lenders make loans to borrowers. In the secondary or national market, private investors and government-sponsored agencies buy and sell real estate mortgages. This helps to provide funds to the primary market and to moderate the effects of local economic conditions and real estate cycles by transferring money from areas where there is a surplus of loan funds to areas where there is a shortage. Government-sponsored secondary market agencies include the Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA), and Federal Home Loan Mortgage Corporation (FHLMC).

The Truth in Lending Act, implemented by Regulation Z, is a federal law that requires lenders to disclose the complete cost of credit to consumer loan applicants. Required disclosures include the total finance charge and the annual percentage rate. In addition, borrowers must be given a three-day right of rescission on home equity loans.

The federal income tax code offers homeowners a number of tax benefits, including the deduction of mortgage interest, property taxes and points, and the exclusion of a gain of up to $250,000 (single) or $500,000 (married) on the sale of a principal residence owned for at least two of the previous five years.

There are both state and federal civil rights and fair housing laws that prohibit discrimination in real estate transactions. The earliest federal law is the Civil Rights Act of 1866, which prohibits discrimination based on race or color in any property transaction.

The federal Fair Housing Act of 1968 prohibits discrimination based on race, color, religion, sex, national origin, handicap, or familial status in transactions involving housing or vacant land intended to be used for residential purposes. There are several exemptions from the Fair Housing Act, but the exemptions do not allow discrimination based on race or color because of the Civil Rights Act of 1866. The exemptions do not apply to any transactions in which a real estate licensee is employed.

Three practices specifically prohibited under the Fair Housing Act are steering, redlining, and blockbusting. Steering is channeling buyers or renters to or away from specific neighborhoods based on protected class characteristics. Redlining is the refusal to make loans on properties located in particular areas for discriminatory reasons, such as crime rates. Blockbusting (panic selling) is attempting to obtain listings or arrange sales by predicting the entry of minority residents into a neighborhood and representing that this will cause a decline in the neighborhood.

Federal laws designed to eliminate discrimination in lending include the Equal Credit Opportunity Act and the Fair Credit Reporting Act.
The Americans with Disabilities Act is intended to ensure equal access to public accommodations for the disabled. The law requires entities with facilities open to the public to eliminate architectural and communication barriers and to provide auxiliary aids and services for the disabled.

Real estate professionals, sellers, and landlords must also comply with state and local fair housing laws.
I. CONVENTIONAL LOANS
A. Conventional mortgages
   1. Debt repayment is based solely on the borrower’s ability to repay; these loans are not insured or
guaranteed by the government.
   2. The LTV can be up to 80%.
B. Insured conventional mortgages
   1. A buyer (borrower/mortgagor) pays PMI when the LTV is above _________.
   2. Private mortgage default insurance protects lenders from loss due to a deficiency, which would
occur after a foreclosure.
      a) PMI does not ________________________________
         (1) PMI covers the shortfall between the amount obtained by the foreclosure and the out-
standing mortgage debt.
      b) It gives lenders additional coverage along with the right to foreclose and take the property.
         (1) Example: A borrower gets a 95% loan with PMI. If the borrower defaults, the lender
would be protected for the 15% difference between 95% and 80%.
      c) The advantage for the borrower is a ________________________________.
   3. A borrower with an LTV of 80% or less may obtain an uninsured conventional loan because the
chance of default is much less.

II. GOVERNMENT FINANCING PROGRAMS
A. FHA-insured loan program (Federal Housing Administration)
   1. FHA provides its own mortgage default insurance.
      a) It ________________________________ due to borrower default.
      b) A mortgage insurance premium, which insures the entire loan balance, is paid by the bor-
rower in cash or financed and paid monthly.
   2. Loan funds come from approved lenders, not FHA.
      a) Interest rates are set by lenders, not FHA.
      b) The properties must be ________________________________.
   3. FHA traditionally has permitted a ________________________________
      than conventional mortgage loan programs.
   4. There is no prepayment penalty.
      a) Loan payoff will be based on the ________________________________
   5. The purchase agreement must contain an escape clause (contingency clause) that offers a refund
provision.
      a) If loan cannot be obtained, the buyer can cancel.
6. The loan is always assumable (no due-on-sale clause). The conditions depend on the date of loan origination.
   a) The lender’s approval is required for assumption of loans originated since 1989.
      (1) An assumption will not need an appraisal.

B. VA-guaranteed loan program (Department of Veterans Affairs)
   1. The VA __________________________ lenders against losses on loans to eligible veterans.
      a) Eligible veterans: active National Guard members, veterans, or retired military reserve members
         (1) Does not include __________________________
      b) No insurance premium
      c) Has a funding fee that can be financed
      d) No prepayment penalty or due-on-sale clause allowed
   2. The veteran ______________________ the property as a home.
   3. No down payment is required and the loan-to-value ratio can be up to ______________.
   4. VA requires the following two certificates:
      a) Certificate of __________________________
      b) Certificate of reasonable value (CRV)
   5. The purchase agreement must contain an escape clause.
   7. Non-veterans may assume a VA-guaranteed loan.

C. Real estate professionals’ responsibilities
   1. Real estate professionals are responsible for assisting borrowers with the following:
      a) Disclosing to all parties in the transaction if the borrower cannot qualify
      b) Giving appropriate cautions so the buyer understands the obligations owed to the lender

III. SOURCES FOR REAL ESTATE LOANS
   A. The Federal Reserve
      1. Regulates the supply of money and interest rates in the United States
   B. Primary mortgage market
      ■ Where loans are made
      1. Mortgage bankers provide financing; they are __________________________.
2. __________________________________________________________________________ bring together borrowers and lenders.
   a) __________________________________________________________________________

C. Secondary mortgage market

■ Where loans are bought and sold

1. Secondary market activities
   a) In the primary market, ________________________________________________________.
   b) In the secondary market, __________________________________________________________________________ mortgages are bought from banks to provide capital to the primary mortgage and lending process.
   c) Mortgage-backed securities are sold to investors.
   d) If their mortgage is sold on the secondary market, borrowers may be directed to __________________________________________________________________________ or company, but their loan terms do not change.

2. Three main organizations
   a) FNMA: government-sponsored corporation that __________________________________________________________________________ of mortgages (Federal National Mortgage Association—Fannie Mae)
   b) GNMA: agency within HUD that buys FHA and VA mortgages (Government National Mortgage Association—Ginnie Mae)
   c) FHLMC: government-sponsored corporation that mainly buys conventional mortgages from savings and loan associations (S&Ls) and commercial banks (Federal Home Loan Mortgage Corporation—Freddie Mac)

3. Conforming and nonconforming loans
   a) A conforming loan meets the standards of Fannie Mae and Ginnie Mae and can be readily sold in the secondary market.
   b) A nonconforming loan, such as a “jumbo loan” that is larger than Fannie Mae standards, may be more difficult to sell on the secondary market.

IV. CONSUMER PROTECTION LAWS

A. Two laws

1. Truth in Lending Act/Regulation Z—lender costs
   a) Annual percentage rate (APR) = true cost of credit

2. RESPA—All closing costs
   a) Good-faith estimate at application
   b) HUD-1 at closing
B. Truth in Lending Act (Federal Reserve Regulation Z)

1. Purpose: to promote the informed use of consumer credit by requiring advance disclosures of loan terms and costs
   a) Four primary disclosures required of lenders
      (1) The APR is expressed as the loan’s APR; it is not the same as the interest rate.
         (a) The APR, also known as the effective rate, expresses the relationship of the total finance charge to amount financed.
         (b) The APR will be greater than the “face rate” or “nominal interest rate.”
      (2) The total finance charges associated with the loan include nominal interest, origination or assumption fee, borrower-paid points, and mortgage insurance costs.
      (3) The total number and amount of all payments must be disclosed by the lender.
      (4) The total amount financed must be disclosed by the lender.
   b) Applies only to charges paid by the borrower
      (1) Does not disclose
   c) Does not include payments to third parties (i.e., title insurance, legal fees,)
   d) Additional costs associated with closing are not included in the finance charge (e.g., closing expenses, legal fees, title insurance premium, and seller paid points)
   e) Applies to all real estate loans except the following:
      (1) Loans to corporations
      (2) Business or commercial loans
      (3) Seller financing (purchase money mortgage or contract for deed)

2. Right of rescission
   a) Requires a ________________ for refinances of owner-occupied, one- to four-unit properties and home equity loans
      (1) Rescission does not apply to ________________ .

3. Advertising requirements
   a) The asking price and/or APR are the only specific finance terms allowed in an advertisement without triggering a full disclosure requirement.
   b) Information about the down payment, interest rate, monthly payments, or number of payments requirement (the small print).
c) General statements (e.g., “low down payment” or the amount of)

______________________________________________________________ that are not related
to financing are allowed.

(1) Example ad: “$150,000 purchase price with an APR of 5.5%; call for other great terms;
HOA $50 per month; taxes $1,200 per year” (no trigger)

(2) Example ad: “$150,000 purchase price with 100% financing and a payment of $675
per month” (would trigger full disclosure of the interest rate, number of payments, and
so on.)

4. Remember
   a) Truth in Lending Act = ________________________________
   b) RESPA = ________________________________

V. INCOME TAXATION AND HOMEOWNERSHIP

Real estate brokers should not advise on tax advantages or disadvantages but should recommend that
buyers and sellers seek the advice of a qualified tax consultant.

A. Deductions on a first or second residence

1. Property taxes (ad valorem taxes)
2. Mortgage interest
3. Points paid on loans used to improve or acquire
4. Some loan origination fees
   a) Remember ____________________: points, origination, interest, and taxes are deductible
   b) Not deductible: insurance, association dues, repairs, or capital improvements
5. Must ________________________________ tax return to take deductions

B. Capital gains

1. Short-term gain on property held 12 months or less is taxed at rate payer’s ordinary income tax
   rate.
2. Long-term gain on property held more than 12 months is taxed at a different rate than ordinary
   income.
3. Salespersons and brokers should recommend that buyers and sellers seek tax advice.

C. Taxation of gain on sale of principal residence

1. Gain from the sale of a principal residence is excluded from tax.
   a) __________________________ maximum if single taxpayer
   b) __________________________ maximum if married and filing jointly
2. The taxpayer must own and occupy for at least _______________________ years prior to the sale.
   a) The two years do not have to be sequential.
   b) There are no other requirements such as age or buying other properties.

3. Capital gain calculation
   a) Example
      
      Step 1:
      
      Acquisition cost $140,000
      + Cost of improvements $30,000
      = Adjusted basis $170,000

      Step 2:
      
      Sales price $205,000
      – Selling expenses $14,500
      = Adjusted sale price $190,500

      Step 3:
      
      Adjusted sale price $190,500
      – Adjusted basis $170,000
      Realized capital gain $20,500

D. Depreciation

1. A tax advantage of owning business and investment real estate is depreciation on personal taxes.
   a) This offsets the lack of liquidity in real estate.

2. Real estate investors and business property owners may take a depreciation allowance on real estate improvements they own (land does not depreciate).
   a) The residential rental property allowance is ________ years.
   b) The commercial property allowance is ________ years.

3. The amount is determined by the ____________________________.

4. The formula is the value of the improvements divided by the number of years being depreciated times the number of years already taken.
   a) Example: A commercial property has improvements valued at $390,000, which are being depreciated over 39 years. How much has the property depreciated after eight years?
      
      (1) Solution: $390,000 ÷ 39 × 8 = $80,000
E. **1031 tax-deferred exchanges (also called like-kind exchanges)**

1. 1031 exchanges are used by investors and business property owners to defer paying capital gains taxes on investment properties.
   a) The taxes will have to be paid in the future because it is a deferral, not an exclusion.

2. It allows investors or business property owners to sell a property, buy a new property, and defer paying capital gains tax on the sale.
   a) The investor will not have to pay taxes at closing on the first property. It defers the payment until the sale of the new property.
   b) There are many exacting rules for how the exchange must be carried out.
      (1) The salesperson or broker should recommend that the investor or property owner seek tax advice.
   c) Personal and secondary residences are not eligible for a 1031 exchange.

VI. **FAIR HOUSING LAWS**

A. **Civil Rights Act of 1866**

1. The act prohibits any discrimination based on race in the sale and rental of all property.
2. There are no exceptions to this federal act.

B. **Federal Fair Housing Act/Civil Rights Act of 1968**

1. Protected classifications in the sale and rental of residential property
   a) Race
   b) Religion
   c) Color
   d) Sex
   e) National origin
   f) Familial status
      (1) Added in 1988, it protects any family with under the age of 18. It also includes pregnant women and those fighting for child custody.
   g) Handicap/disability
      (1) Added in 1988, it includes protection of those with HIV or AIDS.
2. Classifications that are not protected
   a) Sexual orientation
   b) 
   c) status
   d) Occupation (e.g., student)
3. Exemptions
   a) If there is a conflict between federal, state, and local laws, the strictest law will prevail.
   b) Real estate brokers and salespeople may not discriminate.
   c) All advertising must be in compliance with the law; there are no exemptions.
      (1) ____________________________ used to advertise housing, including online blogs and
           social media, fall under this rule.
   d) It is not unlawful to discriminate based on religion, color, sex, national origin, familial status,
      or handicap/disability in the following situations:
      (1) Rental or sale of a single-family home by the owner (___________)
          (a) No broker and no discriminatory advertising
      (2) Rental of units (in a building with four units or less) if the owner occupies one of the
          units
          (a) No exemption for buildings with more than four units, even if the owner or owner’s
              family occupies a unit
          (b) No broker and no discriminatory advertising
      (3) Private clubs, not open to the public, may restrict lodgings to members only
      (4) Religious organizations may give preference to their members for other than commercial
          purposes. Religion or denomination must not limit membership based on race, color, or
          national origin
      (5) ____________________________ is allowed to refuse occupancy in rental or
          sale of units to families with children if the senior housing has at least ________ of the
          units occupied by at least one person aged _______ or older

4. Prohibitions
   a) It is a violation of the federal Fair Housing Act to do any of the following related to housing
      accommodations (residential property) based on membership of a protected class:
      (1) Refuse to show, rent, sell, negotiate, or deal (if asked by seller or buyer to discriminate,
          broker should cancel agency)
      (2) Offer different terms
3. Advertise in a discriminatory fashion, including ads in newspapers, social media, and other online sites
   (a) May not advertise against any protected class
      i) Unacceptable example: “no children” or “no Caucasians”
      ii) Acceptable example: “no smoking”
   (b) Advertise the property, not who should occupy it

4. Steering—potential buyers to or away from particular areas as a means of discrimination—also called

5. Disability defined
   a) A disability is any physical or mental impairment that substantially limits one or more major
      (1) Includes those suffering from HIV/AIDS
      (2) Alcoholics and drug addicts protected if seeking treatment, but not protected if using illegal drugs
         (a) May not discriminate against medical marijuana users; state laws determine what rules apply
      (3) Law specifically excludes those convicted of dealing drugs
      (4) Both current and recovered mental patients protected

6. Property management issues
   a) Landlords must allow disabled tenants to make changes to units.
      (1) Tenant must return the unit to its original state.
      (2) Landlords may not charge an extra.
      (3) Landlords cannot charge additional rent or a pet deposit for a service animal, or deny tenancy because of the presence of a service animal.
      (4) Landlords are not required to rent to disabled tenants who have a history of.

7. Complaints
   a) Complaints can be filed at the federal or state level.
   b) At the federal level, complaints must be filed with HUD within one year.
c) Complaints can be filed directly in federal court within _________________.
   (1) The first step is for HUD or the state to ________________ the complaint.
d) HUD, FHA, or VA may not revoke a real estate license.
e) In a complaint, HUD will consider the following:
   (1) Testing studies done on the company by HUD
   (2) The properties shown to the buyer or tenant
   (3) If an equal opportunity poster is displayed in the office
f) HUD does not consider the intentions of brokers or salespersons even if they felt like they
   were working in the consumer's best interest.

8. Penalties
   a) May include injunctions, damages, court costs, attorney's fees, and civil penalties
   b) No imprisonment; not a criminal offense

9. Broker must display the equal opportunity poster
   a) The poster must be in each office or place of business.
   b) Failure to display the poster can shift burden of proof to the broker in an alleged discrimina-
      tion complaint.
   c) The equal housing logo should be used in advertising, but it is not a federal requirement.

10. Protect against claims of discrimination by ____________________________
    (e.g., all showings, disclosures)

C. Megan’s Law

1. Megan’s Law requires the registration of sex offenders.
2. Brokers should inform buyers who may be concerned about a registered sex offender to contact
   local law enforcement offices.
3. The broker’s obligation to disclose and inform buyers about this law varies by state.

D. Equal Credit Opportunity Act (ECOA)

1. The purpose of ECOA is to make consumer credit available with fairness and impartiality. If
   applicants meet qualifying requirements, their membership in a protected class should have no
   bearing on their approval.
2. It prohibits discrimination in all consumer credit transactions and does not allow lenders to deny
   credit to qualified applicants on the basis of race, color, religion, national origin, sex, marital
   status, age, or dependence on public assistance.
3. ECOA adds the protected classes of
   ____________________________.
   a) It does not protect minors, families, or those with an erratic employment history.
4. Lenders are required to provide a written notice of why a borrower was denied a loan.
E. Americans with Disabilities Act (ADA)

1. ADA is intended to ensure equal access to public accommodations for disabled persons.
2. A public accommodation is any private entity with facilities, such as a real estate office.
3. ADA requires removal of architectural and communication barriers and provision of auxiliary aids and services, if “readily achievable.”
4. New commercial construction must be accessible to the disabled.
5. Disabled residential tenants may make modifications. They must return the unit to its original condition.
6. ADA uses the same definition of a disability discussed earlier.

VII. ETHICS FOR REAL ESTATE PROFESSIONALS

Ethics refers to a system of moral principles, rules, and standards of conduct.

A. Expectations of brokers and salespersons

1. Exhibit a higher level of knowledge and competency than a nonlicensed individual
2. Protect the interests of clients and treat all parties fairly and honestly
3. Complete all state-mandated disclosures in a timely fashion
4. Fully explain to the client the obligations of the client and the broker in the transaction
5. Disclose all material facts in a timely manner without fraud or misrepresentation

B. Disclosure and practicing within levels of competence

1. All real estate professionals are expected to know when they are to perform a task. This includes the following:
   a) Practicing outside their area of expertise (e.g., residential broker selling commercial property or city broker selling farm land)
   b) Completing and presenting legal documents that are not fully understood by the broker
2. A salesperson or a broker becomes competent by completing education and working with others who are knowledgeable in the area of practice.
3. Real estate professionals are expected to fully disclose the following:
   a) Whom they represent in the transaction
   b) The obligations of all parties, in regard to disclosure of material defects
   c) If they are a principal in the transaction
   d) If there may be any environmental, material, or other issues requiring disclosure that might impact the property
C. Illegal practice of law

1. Real estate professionals must know when they need to recommend that the party they are working with should seek legal advice.

2. Broker associates and salespersons should recommend the use of attorneys, accountants, and other appropriate counsel to buyers and sellers.

3. Licensees are not allowed to give legal advice on any aspect of real estate transactions.

D. National Do Not Call Registry

1. The National Do Not Call Registry is a list of phone numbers that telemarketers are not allowed to call.

   a) Real estate brokers and salespeople must check the list before cold calling.

2. Brokers and salespeople may contact consumers for ____________________________ after the consumer has made an inquiry.

3. Brokers and salespeople may call consumers with whom they have “an established business relationship” for ____________________________ after the last purchase.
UNIT 8 GLOSSARY REVIEW

1. A uniform measure of the cost of credit that includes interest and finance charges is known as the ____________________________.
2. Lenders who define an area in which they will not lend as a means of discrimination are ____________________________.
3. The document that shows a veteran has the right to purchase a home using a VA loan is a ____________________________.
4. Channeling buyers away from particular neighborhoods based on their ethnic background is illegal and is called ____________________________.
5. A government-sponsored secondary mortgage market organization that buys both conventional and government loans from primary lenders is ____________________________.
6. An agency of the federal government that guarantees loans made to veterans is the ____________________________.
7. A government agency that insures (but does not make) mortgage loans is the ____________________________.
8. Refusing to make a mortgage loan to an 80-year-old person is a violation of ____________________________.
9. The law that requires a three-day right of rescission for home improvement loans is the ____________________________.
10. ECOA adds protection from discrimination based on ____________________________, which is not protected under fair housing law.
11. When HUD receives a complaint, the first step HUD takes is to ____________________________ it.
12. Senior housing communities are allowed to discriminate based on ____________________________.
13. The ____________________________ prohibits discrimination based on race.
14. A real estate salesperson or broker advertising that the “neighborhood is changing” might be guilty of ____________________________.
15. Insurance used in high LTV conventional loans that gives lenders additional protection in case of default is ____________________________.
UNIT 8 QUIZ

1. FHA insurance is designed to protect the
   a. mortgagor.
   b. lender.
   c. seller.
   d. broker.

2. A 100% loan-to-value ratio is a feature of many
   a. FHA-insured loans.
   b. VA-guaranteed loans.
   c. conventional loans.
   d. conventional guaranteed loans.

3. A borrower might choose to pay private mortgage insurance in order to
   a. have more equity.
   b. reduce the monthly payment.
   c. have a lower LTV.
   d. bring a smaller down payment to closing.

4. Which of the following loans would be subject to a right of rescission?
   a. Purchase of a new home
   b. Home improvement loan
   c. Construction loan for a home
   d. Purchase of a second home

5. Which of the following ads would NOT trigger full disclosure under Regulation Z?
   a. “Low down payment—only $500”
   b. “Below market interest rate—only 2%”
   c. “100% financing with easy terms”
   d. “HOA dues $350 per year”

6. The primary function of the secondary mortgage market is to
   a. grant new loans.
   b. supply funds to the primary market.
   c. purchase contracts for deed.
   d. insure mortgages.

7. Which of the following statements about the annual percentage rate is TRUE?
   a. It is the disclosure of the note rate as required by Regulation Z.
   b. It is the interest rate stated on the note.
   c. It includes the nominal interest rate and finance charges.
   d. It shows that the true cost of financing is always lower than the note rate.

8. Fair housing laws provide for exemptions from compliance in certain circumstances. The act allows an exemption for
   a. a church-owned apartment complex if language in the lease restricts tenancy to members of a specific national origin.
   b. a commercial restaurant and lounge owned by a private club that refuses to admit individuals of a certain ethnic group.
   c. the absentee owner of a four-unit building who charges a higher rent to members of a certain religious group.
   d. the owner of an unlisted home who advertises simply by placing a For Sale sign on the property.

9. A buyer has just purchased a home and has applied for a new loan. The Truth in Lending Act requires the lender to inform the borrower of the
   a. three-day right of rescission.
   b. total amount of closing costs.
   c. exact amount of monthly payments.
   d. true cost of obtaining credit.

10. Which of the following is TRUE about a renter of a single-family home who has recently become disabled?
    a. The tenant may build a ramp at the tenant’s expense.
    b. The landlord must build a ramp at the landlord’s expense.
    c. The tenant must vacate the premises within 30 days.
    d. The landlord must reduce the tenant’s rent.

11. In renting residential units, a property manager may legally
    a. refuse to rent to a pregnant person.
    b. designate adults-only floors.
    c. charge individuals with children a higher security deposit than other adult renters.
    d. require handicapped tenants who made alterations to restore the property to its original condition upon lease termination.
12. Fran sold her house that she owned in severalty and had a capital gain of $175,000. In order to exclude that gain from her income for tax purposes, she must
   a. be at least 55 years of age.
   b. have lived in the house for three years.
   c. have lived in the house for two of the last five years.
   d. have lived in the house for two of the last three years.

13. Which of the following is NOT a protected group under federal fair housing laws?
   a. Sex
   b. Age
   c. Race
   d. Handicap

14. Parties who believe they have suffered from housing discrimination may file a complaint in federal court within
   a. 90 days from the incident.
   b. 2 years from the incident.
   c. 10 years from the incident.
   d. a reasonable time.

15. A real estate salesperson is working with a couple who just arrived from Russia. He only shows them homes that are in neighborhoods with Russian immigrants and Russian-speaking merchants and services. This is
   a. thoughtful.
   b. blockbusting.
   c. steering.
   d. redlining.

16. If HUD believes fair housing law has been violated, which would be the first action taken?
   a. Wait until at least one more incident is reported
   b. File a lawsuit
   c. Take the broker's license
   d. Start an investigation

17. What can be deducted from income taxes?
   a. Points, interest, and HOA dues
   b. Taxes, points, and insurance
   c. Origination fee, points, and taxes
   d. Points, insurance, taxes, and interest

18. The federal law that adds age as a protected class is
   a. FHA.
   b. ECOA.
   c. FNMA.
   d. RESPA.

19. Qualified senior housing is allowed to discriminate against
   a. age.
   b. religion.
   c. familial status.
   d. national origin.

20. A lender refusing to lend in an area of high crime rates might be guilty of
   a. theft.
   b. blockbusting.
   c. steering.
   d. redlining.

21. A consumer on the National Do Not Call Registry may be contacted by a real estate professional if the consumer made an inquiry within the last
   a. 3 months.
   b. 6 months.
   c. 12 months.
   d. 18 months.

22. Interest rates are MOST likely to be impacted by
   a. government loan insurance programs like FHA.
   b. government guarantees on loans to veterans.
   c. depreciation and capital gains laws.
   d. policies set by the Federal Reserve.

23. Which of these is TRUE about the do-not-call registry law?
   a. It has little, if any, impact on the real estate business.
   b. It requires an option to opt out and a 30-day notice to the consumer.
   c. It should be followed by all real estate professionals.
   d. It requires registration to avoid fines.
24. Which entity offers VA and FHA loans to borrowers?
   a. VA or FHA approved lenders
   b. VA or FHA, depending on which loan is chosen
   c. HUD
   d. Any local bank or mortgage broker

25. To deduct items on personal income tax, the taxpayer
   a. should have the form prepared by an accountant.
   b. must use an itemized form.
   c. may deduct only those items that apply to the taxpayer's primary residence.
   d. must determine if a gain was made before filing.

26. An investor who does not want to pay capital gains tax on the sale of an investment property should consider
   a. claiming the investment property as a primary residence.
   b. moving into the property for a year to get a primary residence exclusion.
   c. not filing an itemized return.
   d. using a 1031 tax-deferred exchange.

27. Is it acceptable for an apartment building to advertise its apartments as “for adults only”?
   a. No, because it is illegal and discriminates against children.
   b. Yes, if each unit has at least one person over 55 living in it.
   c. Yes, it is legal per federal, state, and local laws.
   d. No, it is illegal because fair housing laws protect age.

28. If a qualified borrower is refused a loan because the borrower is retired and receiving public assistance, the lender is in violation of
   a. HUD.
   b. RESPA.
   c. FHA.
   d. ECOA.

29. The loan-to-value amount lenders will give buyers is determined by the
   a. lower of the sales price or appraised value.
   b. sales price only.
   c. appraised value only.
   d. higher of the sales price or appraised value.
UNIT 8 QUIZ ANSWERS

1. b The lender's unpaid balance is insured by the FHA against losses resulting from the borrower's default.
2. b The VA-guaranteed loan program is one of only a few types that allows a 100% loan-to-value ratio.
3. d A borrower would choose to pay private mortgage insurance in order to have a higher loan to value and bring less down payment to closing.
4. b Home improvement loans and home equity loans must provide the borrower with a three-day right of rescission, but it is not required for new construction loans or primary loans for the purchase of a home.
5. d HOA dues, property tax amounts, the sales price, and APR do not trigger full disclosure.
6. b The primary purpose of the secondary mortgage market is to provide funding to the primary market.
7. c The APR includes the nominal (note) rate, plus other finance charges.
8. d The owner of a single-family residence may discriminate based on religion, color, sex, national origin, disability, or familial status, as long as a broker's services are not used and none of the advertising indicates an intention to discriminate.
9. d Regulation Z requires that lenders, at the time of loan application, disclose the true cost of financing.
10. a The tenant must be allowed to make changes to the property at the tenant's expense. The landlord may require the tenant to return the property to its original condition upon lease termination.
11. d The tenant must be allowed to make changes, and the landlord may require that the property be returned to its original condition upon lease termination. Pregnant women and individuals with children are covered under the familial status category.
12. c Homeowners may exclude gain from the sale of a principal residence they have lived in for two of the last five years. The maximum exclusion is $250,000 for a single person.
13. b Age is not a federal fair housing protected class, but it is included in the protections of the Equal Credit Opportunity Act.
14. b Complaints regarding housing discrimination may be filed within two years in federal court.
15. c Selecting properties to show based on any protected class (national origin) is prohibited. This channeling is called steering.
16. d HUD will start by investigating any complaint.
17. c Remember POIT: points, origination fees, interest, and taxes can be deducted. HOA dues and principal payments are not deductible from income taxes.
18. b The Equal Credit Opportunity Act adds age as a protected class.
19. c Qualified senior housing is allowed to discriminate against dependent children under 18 (familial status).
20. d Lenders are not allowed to refuse to lend based on crime rates in an area.
21. a National Do Not Call Registry rules state that real estate professionals may contact consumers for three months after the consumer has made an inquiry.
22. d Federal Reserve policies have the most impact on interest rates.
23. c The do-not-call registry law applies to the solicitation of consumers and should be followed by all real estate professionals.
24. a FHA and VA loans may be obtained only from approved primary lenders.
25. b Itemized tax forms must be used to obtain deductions, such as depreciation.
26. d A 1031 tax-deferred exchange would allow the investor to defer paying capital gains until a later date.
27. b Approved senior housing in which 80% of the units are occupied by persons over 55 may discriminate and rent to adults only, not families.
28. d ECOA does not allow discrimination in lending based on age or the receipt of public assistance. If the person receiving assistance qualifies, then the loan must be made.
29. a LTV is determined by the lower of the sales price or appraisal.
LEARNING OBJECTIVES  When you have completed this unit, you will be able to

- **explain** the concepts, terminology, and disclosure requirements associated with agency relationships;
- **identify** the major components of the agency agreements and the obligations of brokers under them; and
- **demonstrate** how real estate commissions are calculated and how funds are managed using trust accounts.

Study Plan
Before Class:
Complete the reading assignment in *Modern Real Estate Practice* listed in the MREP Workbook Reading Guide.
Read the Unit 9 Key Points.

After Class:
Complete the Glossary Review.
Complete the Review Exam.
Prepare for the Final Exam (see Unit 10 for a study guide).
This unit covers the common law of brokerage representation. Each state further refines the laws and rules of conduct required of agents. For example, some states allow dual agency (the same broker can represent both the buyer and the seller as an agent in same transaction), while others do not. The state portion of your licensing program will define the rules each licensee must follow and explain how they differ from the general or common law of agency.

An agent is a person who is employed to represent or act for someone else (the principal) in dealings with third parties. The agent’s authorized actions are binding on the principal, and the principal can be held liable if the agent’s actions cause harm to a third party (vicarious liability).

The common law of agency creates a fiduciary relationship. The agent’s fiduciary duties to the principal include the duties of obedience, loyalty, disclosure, confidentiality, accountability, and reasonable care and skill (OLD CAR).

An agency relationship may be created by written or oral agreement. Some state laws require an agency agreement between a real estate broker and a consumer to be in writing to be enforceable. Depending on the degree of authority conferred by the principal, an agent may be a special agent, general agent, or universal agent. In most cases, the real estate brokerage firm is a client’s special agent, while a salesperson or broker associate is an employing broker’s general agent.

A dual agent represents both the buyer and the seller at the same time. Dual agency is only allowed if both parties consent to the arrangement.

Every licensee is required to disclose existing brokerage relationships to third parties or their agents. State laws often require that this disclosure be in writing before the real estate professional receives any confidential information from a member of the public.

A listing agreement is an employment contract between a brokerage firm and a seller, appointing the brokerage firm as the seller’s special agent. The three types of listing agreements are exclusive right-to-sell listings, exclusive agency listings, and open listings. A buyer representation agreement is an employment contract between a brokerage firm and a buyer. A property management agreement is the employment agreement between a brokerage firm and landlord.

State law determines the types of representation the brokerage firms in that state will be able to offer buyers and sellers. These types of representation include agency, non-agency, facilitation, single agency, and dual agency.

An agency relationship may be terminated by accomplishment of purpose, expiration of the term of relationship, operation of law, mutual agreement, or revocation.
I. THE ROLES AND RESPONSIBILITIES OF THE BROKERAGE FIRM

A. The broker and brokerage firm

1. The brokerage firm owns all contracts.

2. The employing broker (responsible broker) is responsible for the following:
   a) _______________________________, listings (employment), and purchase agreements
   b) Training and supervising all salespersons and broker associates

B. The role of the salesperson/broker associate

1. Employed to represent the responsible broker and brokerage firm
   a) Owes duties to the client equivalent to the duties owed by the broker

2. Can be an employee or independent contractor
   a) If an employee, the brokerage
      (1) _______________________________, but
      (2) does not have to guarantee vacations, set schedules, or work set hours.
   b) Independent contractors (employed by the firm) must
      (1) have a ____________________________ independent contractor agreement that states
          (a) they may set their ________________________________, and
          (b) must pay their own taxes.
      c) The firm can require independent contractors to conform to office policies.

II. AGENCY RELATIONSHIPS

One party employs another to act on his behalf

A. Parties to an agency relationship

1. Principal: one who ________________________________ another to act on her behalf; may or may not be the person who pays the agent

2. Agent/fiduciary: one who is employed to represent a principal

3. Third party: a party to a transaction who is not a party to the particular agency agreement. Consumer third party is a “customer” and is not represented by any broker

4. Facilitator/transaction-broker: licensee who provides service without being an agent
B. Common law of agency specifies _________________ duties to principal (OLD CAR)

1. _________________
   a) An agent must obey the _________________ directions of the principal.
   b) If principals request that their agents do something unlawful (e.g., intentionally fail to disclose a problem with the property or refuse to show the property to a member of a protected class), then agents should decline the listing.

2. _________________
   a) An agent must place the interest of the principal above all others.
      (1) Example: An agent is obligated to show a buyer all properties that meet the buyer's requirements, not just those with the highest commissions.

3. _________________
   a) Disclosure to the principal and all parties of all known material facts about the property
   b) Full disclosure to the principal of all knowledge about the transaction (including, but not limited to, material facts)
      (1) Example: Listing agent must share with the seller concerns about the buyer's ability to qualify for a loan.
      (2) Example: Buyer's agent should share with the buyer concerns about the property's condition and recommend expert evaluation.
   c) Disclosure to principal of benefits of the transaction as well as the risks or defects

4. _________________
   a) An agent must keep the principal's confidential information private.
      (1) Must keep _________________ (PTM) confidential forever
   b) An agent may release confidential information _________________ from the principal.

5. _________________
   a) Account for any money or personal property entrusted to agent

6. _________________

C. Agent's duties to third parties (often called customers or consumers)

1. Honesty
   a) Must disclose material facts that are known or should be known, even if the principal asks the agent to lie or keep silent
   b) Disclosure required for properties being sold “as is”
2. Fair dealing
   a) At first contact with customers, must inform them to not share confidential information with agents
   b) Agents’ fiduciary duties would require them to share that information with their principal

D. Scope of an agent’s authority
1. Special agency is created when an agent is authorized to perform a particular act
   a) Listing brokerage firm to ___________________________ the principal (in an advisory capacity only).
   b) Buyer brokerage firm to ___________________________

2. General agency is created when an agent is authorized to perform a series of acts associated with the continued operation of a particular business. The agent has a
   a) Salesperson or broker associate to ___________________________
   b) Property manager to ___________________________

3. Universal agency is created when an agent is authorized to perform in place of the principal. The agent has
   a) The agent’s authority comes from a legal form called a ___________________________, which creates an attorney-in-fact.
   b) The agent legally replaces the principal.
      (1) Can accept/reject offers and ___________________________

E. Creation of agency
1. Agency is determined by who ___________________________ the agent, not who _____________ the agent.

2. An ___________________________ may be called a ___________________________.
   a) May be oral or written, depending on state laws
   b) Only written commission agreements are enforceable

3. Implied agency is created through an agent’s actions.
   a) Example: advising a third party to do something

F. Single agency/dual agency/transaction-broker/facilitator
1. A single agent represents only one party to a transaction.

2. Dual agency occurs when a broker represents more than one party to a transaction. The licensee will have limited duties of disclosure.
   a) Typically requires disclosure and ___________________________ of both parties
3. Facilitator or transaction-broker is a non-agency relationship. The licensee provides services to facilitate the transaction. This is not an option in all states.

4. The listing brokerage will often cooperate with the other brokerage that represents the buyer.
   a) The listing brokerage pays a share of its commission to the cooperating brokerage.
   b) State laws typically require the listing broker to obtain the seller's permission to share commissions with a cooperating broker.
   c) Once an offer has been accepted, the buyer’s broker may be referred to as the “selling broker.”

III. BROKERAGE RELATIONSHIP DISCLOSURE REQUIREMENTS (REQUIRED BY ALL STATES)

A. Key points

1. Each state typically requires a brokerage relationship disclosure form to be provided to the consumer (seller or buyer) at first substantive contact and before the broker associate receives any

   a) When representing a buyer, broker associates or salespeople must disclose to the seller or the seller's representative before showing property.

   b) When representing a seller, broker associates or salespeople must disclose to the buyer or the buyer's representative before showing property.

   c) Broker associates or salespeople must disclose if they are a principal or have any interest in the property.

IV. SHERMAN ANTITRUST LAW

A. Price-fixing defined

1. Price-fixing is conspiring to establish fixed fees or prices for services.

B. Price-fixing: illegal and not allowed

1. Price-fixing with other firms or associations violates the federal Sherman Antitrust Act.

2. All fees and commissions charged to the public are ____________________________.

3. Each ____________________________.

   a) Brokerage firms may require all brokers and salespersons within the firm to charge a set price.

   b) Employing brokers may set the fees expected for the firm and may allow each broker associate or salesperson to negotiate with the consumer within certain parameters.

   c) Brokers may not discuss commissions with any brokers ____________________________ of their firm.

4. Commissions ____________________________ or agreement among brokerage firms, MLS systems, broker associates, REALTOR® associations, or the state licensing authority.
C. Additional prohibitions

1. Real estate firms or brokers may not work together to boycott another company or businesses.

2. Non-associated brokerage firms may not work together to assign or split up territories or assign company’s listings based on price range.

V. AGENCY AGREEMENTS/BROKERAGE AGREEMENTS

A. Listing (fiduciary) agreement (specific content determined by state law)

An employment contract that appoints a brokerage firm as an owner’s special agent for the specific purpose of finding a buyer who is ready, willing, and able to buy according to the terms of the contract

1. Parties
   a) Seller = 
   b) Brokerage firm = 

2. Elements of a listing agreement
   a) In writing
   b) Price and terms
      (1) Listing price
      (2) Financing terms
   c) Amount and/or method of compensation
      (1) Flat fee
      (2) Percentage of sales price
      (3) Net listing
         (a) Brokerage receives as commission all money above a minimum agreed sales price
         (b) Illegal or not recommended in most states to protect sellers, who may not be aware of true market value
   d) “Negotiable commission” clause
      (1) Commissions are always _________________, as required by the Sherman Antitrust Act.
      (2) Licensees may only be paid by their brokerage firm.
   e) Definite _________________ dates
      (1) Contract must be amended to extend listing past expiration date
      (2) An automatic renewal clause is not allowed
      (3) Typically obligates the firm to close a transaction, if under contract, even if the listing has expired
f) Multiple-listing clause
   (1) Allows broker to list property in the MLS and offer cooperation (co-op) fee to other brokers
   (2) Listing brokerage and broker represent the ________________________
   (3) Buyer's brokerage and broker represent the ________________________

g) Broker protection/extension/safety/holdover clause
   (1) Brokerage is entitled to a commission if prospect buys after listing expires
   (2) Brokerage must give protective list to seller
   (3) Clause terminates if owner lists with another brokerage

h) Signatures
   (1) Listing agreement must be signed by ________________________________
       to be valid for the sale of the entire property.

3. Types of listings
   a) Exclusive right to sell
      (1) Brokerage gets paid if the property sells, regardless of who finds the buyer
          (a) Even if the ________________________________ the property
      (2) Maximum protection to brokerage; broker will give maximum effort
      (3) Bilateral agreement
   b) Exclusive agency
      (1) Brokerage gets paid if property sells, ________________________________
      (2) Bilateral agreement
   c) Open/nonexclusive
      (1) Only the brokerage who finds (__________________________) the buyer gets paid
      (2) Seller can sign open agreements with more than one brokerage firm
      (3) Unilateral agreement
      (4) Sale to a buyer automatically terminates all other open listings with or without notice

<table>
<thead>
<tr>
<th>FIGURE 9.1</th>
<th>When Does the Listing Agency Get Paid?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of listing</td>
<td>Owner obtains buyer</td>
</tr>
<tr>
<td>Exclusive right to sell</td>
<td>$</td>
</tr>
<tr>
<td>Exclusive agency</td>
<td></td>
</tr>
<tr>
<td>Open</td>
<td></td>
</tr>
</tbody>
</table>

FIGURE 9.1 When Does the Listing Agency Get Paid?
B. Buyer representation agreement

1. Parties
   a) Buyer is principal
   b) Brokerage firm is agent/fiduciary
2. Same elements as listing agreement
3. Can be exclusive right to buy or exclusive agency agreement

C. Obligations of brokers under listing agreement

1. Present all written offers
2. Complete a written offer if buyer requests
3. Pay fees only to licensed brokers
   a) No fees or commissions may be paid to unlicensed persons.
   b) Brokers may pay referral fees to other brokerage firms, but never directly to broker associates or salespeople.
4. Put all agreements in writing, have them signed, and give all parties copies
5. Verify that all marketing is correct and truthful
   a) This includes the disclosure of material facts and property information (e.g., property taxes, HOA dues, etc.).
6. Verify that the buyer has received the seller's property disclosure prior to making an offer
   a) If sellers misrepresent a latent defect in the seller's property disclosure, brokers would not be held liable if they had performed a visual inspection and found no obvious defects.

D. Additional broker obligations to all parties

1. Verify information and statements made by the buyer and the seller, especially if they appear to be untrue
   a) Disclose all known material facts to all parties
2. Complete a visual assessment of the property, looking for material defects, and request a seller's property disclosure
   a) Recommend that the buyer have an inspection to check for latent defects and environmental issues
   b) Point out any “red flag” issues (e.g., sagging floors, water stains, etc.) that may represent potential problems
3. Complete a CMA even if the brokers/salespeople believe they know the current value
4. Answer third-party questions with honesty and clarity
5. Hold trust funds (other people's money) in a trust account
   a) If a brokerage firm accepts and holds funds that belong to others (i.e., security deposits, rents, taxes, insurance, escrow payments, and unearned commissions), then the brokerage firm and employing broker are required to maintain an account for the deposit of trust funds.
   b) Broker associates and salespersons may not have trust accounts.
   c) Licensees must follow requirements when handling earnest money.
      (1) Licensees must give earnest money checks to the listing brokerage firm immediately after the offer is accepted.
      (2) The managing or employing broker of the listing firm must deposit earnest money checks in a trust account.
         (a) The time frame for deposits is set by state law.
         (b) The account must be a general purpose account, which freely allows for the deposit and withdrawal of funds.
   d) Property managers must deposit trust funds (i.e., tenant security deposits, rents for clients, damage deposits) in a trust account.
   e) The commingling of funds is prohibited. Real estate professionals cannot deposit personal funds or the firm's funds with trust funds.
      (1) Referral fees and earned commissions are not kept in a trust account.
   f) _______________________ is when trust funds are used for personal reasons or given to the wrong people.
   g) Brokers must keep accurate records of all money deposited in and disbursed from the trust account.
   h) If the broker receives an NSF (not sufficient funds) check, the broker must immediately inform the seller.

E. Property management agreement

1. A property management agreement is a contract between the owner of an income-producing property and a brokerage firm that will act as the property manager.

2. The parties to the agreement are the following:
   a) Property owner—___________________________
   b) Property manager (brokerage firm)—___________________________
      (1) Broker associates and salespeople may not be a party or sign without the permission of the managing broker.

3. The manager's responsibilities in the agreement are financial, physical, and administrative management to do the following:
   a) _____________________________ of the property
4. Management responsibilities include the following:
   a) Marketing space to attract tenants
   b) Collecting rents and complying with rent control rules
   c) Negotiating leases, including investigating applicants’ qualifications
   d) Developing a budget and preparing financial reports, including reserves for replacement of short-life items such as air conditioners, appliances, carpeting, and so on

   (1) The manager has authority to paint the unit but not to make capital improvements, such as a total renovation of the unit.

5. Brokers managing industrial/manufacturing properties may be concerned about environmental issues.

F. Termination of agency agreements

1. Full performance, closing, or expiration of the agreement
2. Death or bankruptcy of principal or brokerage firm (not salesperson or broker associate)
3. Destruction of improvements
4. Mutual rescission
5. Breach by either party
   a) Terminates the agreement, but there may be liability issues

VI. WARRANTIES

A. Home warranty programs—cover existing homes

1. Home warranties cover the majority of the home, including all major systems and appliances.
2. Home warranties are often provided as part of the listing or offer.
3. The terms and length are determined with the warranty company.
4. Warranties usually feature a deductible and may exclude some items from coverage.
5. Real estate professionals should make sure buyers know that warranties are available.
6. Disclosure requirements for warranties vary based on state law.

B. New home construction warranties

1. This warranty is provided on newly constructed homes by the builder and must meet strict underwriting guidelines. It is also known as a warranty of habitability or suitability.
   a) Covers roof or other structural failure, poor materials or workmanship, or faulty appliances after closing
   b) Does not cover from outside forces
2. The requirements for builder warranties are set at the state or local level.
3. Third-party companies can give buyers additional coverage for new construction.
4. Real estate professionals should make sure buyers fully understand the limits of all warranties.

VII. BROKERAGE FEES (SALES COMMISSIONS)

A. Commission circle formula (see Figure 9.2)
   1. Hint: This circle formula is easy to remember—what you want to earn is CRiSP new dollars.

   **FIGURE 9.2**
   Commission Circle Formula
   
   \[ C = R \times SP \]
   
   2. To find the commission when the rate and sales price are known, cover up the \( C \) so \( R \) and \( SP \) are both below the line and separated by the “\( \times \)”.
   3. The formula is: \( C = R \times SP \).

B. Example 1: Calculating a sales commission
   1. A seller agreed to pay a 6% commission on the home she listed with a broker. The home sold for $80,000. How much was the commission?

   \[
   \begin{align*}
   C &= \text{commission} \\
   R &= \text{rate} = 6\% \ (0.06) \\
   SP &= \text{sales price} = $80,000 \\
   C &= R \times SP \\
   C &= 0.06 \times $80,000 = \ldots
   \end{align*}
   \]

C. Example 2: Sales price
   1. The commission received was $4,800 and the rate was 6%. What was the sales price?
      a) Commission divided by the rate: $4,800 \div 0.06 = \ldots$
   2. How can you solve for the rate?
      a) Commission divided by sales price: $4,800 \div $80,000 = 0.06 or 6%
UNIT 9 GLOSSARY REVIEW

agent  
brokerage firm  
buyer  
commingling  
conversion  
dual  
exclusive agency  
exclusive right-to-sell  
bigliantry  
general  
generate income  
well-qualified tenants  
immediately  
listing agreement  
maintenance  
maintain value  
three days  
trust account  
multiple  
negotiation  
open  
principal  
seller  
third party  
trust account

1. One who employs an agent to act on her behalf is a _____________________________.
2. The person employed by a principal to act on his behalf is an _____________________________.
3. Commissions charged by brokerage firms for their services are set by _____________________________.
4. A listing agreement in which the owner agrees to pay the agent a commission regardless of who sells the property during the listing period is an _____________________________.
5. A buyer representation agreement that appoints a broker as the sole agent to find a property for a buyer, but allows the buyer to find her own property without paying a commission, is an _____________________________.
6. A listing that allows an owner to list concurrently with more than one broker is an _____________________________.
7. The relationship of a broker to his principal is a _____________________________.
8. When a broker serves as the agent for both the buyer and the seller, it is a _____________________________.
9. Earnest money must be deposited in the broker's _____________________________.
10. Depositing a client's money in the same account with the broker's money (which is illegal) is _____________________________.
11. Using trust funds for personal reasons is _____________________________.
12. The first responsibility of a property manager is to _____________________________.
13. A property manager should seek _____________________________.
14. The buyer's broker should deliver the earnest money to the listing broker _____________________________.
15. Real estate commissions charged by a firm are determined by the _____________________________.
UNIT 9 QUIZ

1. A listing broker is typically the
   a. seller's agent.
   b. buyer's principal.
   c. buyer's agent.
   d. third party.

2. In an exclusive right-to-sell listing, the principal contracts
   a. with several brokers, each of whom deals with only one third party.
   b. to pay the broker a commission regardless of who procures the buyer.
   c. with only one broker, but reserves the right to sell the property herself without paying a commission.
   d. with several brokers.

3. All of the following will terminate a listing without liability EXCEPT
   a. destruction of the property.
   b. mutual agreement.
   c. expiration.
   d. death of the salesperson.

4. The document used to form the relationship between the agent and the principal is
   a. an open listing.
   b. a fiduciary agreement.
   c. a facilitations contract.
   d. a lease.

5. If the principal insists that he will not sell his house to members of a certain ethnic group, the broker must
   a. obey his request, in accordance with the law of agency.
   b. report the seller to the police.
   c. refuse to honor the request.
   d. obey the request but decline a commission.

6. The amount of commission paid to a broker is established by
   a. state law.
   b. negotiation between the broker and the seller.
   c. local custom.
   d. real estate boards.

7. A listing in which the principals agree to contract with only one broker but reserve the right to sell the property themselves without paying a commission is
   a. an exclusive agency listing.
   b. an open listing.
   c. an exclusive right-to-sell listing.
   d. a net listing.

8. The owner of a property has signed an exclusive right-to-sell listing contract. Which of the following is TRUE?
   a. The owner has promised to accept a reasonable offer.
   b. The owner has promised to accept any offer identical to the listed price and terms.
   c. The owner has promised to pay a commission if the property is sold during the listing period.
   d. The owner will pay only the broker who finds a buyer.

9. The clause in a listing agreement that protects the broker's commission if someone with whom the broker negotiated purchases the property after the expiration of the listing is known as a
   a. nondiscrimination clause.
   b. protection or safety clause.
   c. due-on-sale clause.
   d. cooperation clause.

10. A property manager is BEST described as a
    a. general agent.
    b. special agent.
    c. universal agent.
    d. facilitator.

11. In an open listing, a broker receives a commission
    a. by procuring the buyer.
    b. by offering a co-op to other brokers in the MLS.
    c. from anyone who sells the property.
    d. only if the seller does not sell the property.
12. Which is an example of commingling?
   a. The broker deposits earnest money in her trust account.
   b. The broker deposits earnest money in her business account.
   c. The broker deposits commissions earned in her business account.
   d. The broker deposits a tenant’s security deposits in a property management trust account.

13. If a broker and a seller have a fiduciary relationship, the broker could
   a. inform a buyer that the seller will accept substantially less than the listed price.
   b. fail to tell the buyer about hidden structural problems in order to protect the seller.
   c. disclose the buyer’s financial qualifications.
   d. honor the seller’s request to refuse to show the property to minorities.

14. If a seller informs a broker that the house is for sale “as is,” which of the following would be an appropriate action for the broker?
   a. The broker informs all potential buyers that there is nothing wrong with the property even though the broker has not inspected it.
   b. The broker visually inspects the property, sees a water leak in the ceiling and informs potential buyers about it.
   c. The broker agrees to allow the seller to handle all conversations with potential buyers about the condition of the property.
   d. The broker advises potential buyers that an “as is” property requires no property disclosures.

15. Which of these would be LEAST likely to appear in a listing agreement?
   a. Negotiable commission clause
   b. Expiration date
   c. Listing price
   d. Estimated closing costs

16. When a property manager signs a property management contract with an owner, the property manager is a
   a. fiduciary of the property owner.
   b. third party to the contract.
   c. universal agent of the broker.
   d. principal of the property owner.

17. While showing an income-producing property, the broker advised the buyer that the property is likely to be very profitable in the future because of its location. The broker’s actions might result in the creation of
   a. a universal agency.
   b. an agency coupled with an interest.
   c. an agency-in-fact.
   d. an implied agency.

18. A real estate licensee acting solely as a seller’s agent is MOST likely to be held liable for claims of misrepresentation by a buyer if the licensee committed which of these acts in the course of the transaction?
   a. Failed to provide previous purchase prices for the property
   b. Obeyed the seller’s instructions to leave all discussions of property condition to the seller
   c. Continued to accept and present offers on the property after the seller accepted the buyer’s offer
   d. Deposited the earnest money check in a personal account to clear before transferring it to the trust account

19. A real estate agent’s fiduciary obligations include which of the following?
   a. Care and diligence to the principal
   b. Receive fair and adequate compensation from the third party
   c. Disclosure of confidential information about the principal
   d. Loyalty to third parties

20. A seller tells the broker that if he sells the seller’s home, the seller will pay him a commission. This arrangement is MOST similar to which listing agreement?
   a. Exclusive right to sell
   b. Exclusive agency
   c. Open listing
   d. Net listing

21. The property manager’s first obligation is to
   a. maintain the value of the property.
   b. earn a profit.
   c. find high quality tenants.
   d. hire good contractors.
22. A home sells for $325,000 and the brokerage firm receives $19,560 in commission. What was the commission rate paid by the seller?
   a. 3%
   b. 5%
   c. 6%
   d. 17%

23. The listing broker splits commissions with the cooperating broker on a 60:40 basis with 60% retained by the listing company. The cooperating (selling) brokerage splits with the selling salesperson with 70% to the salesperson. What does the selling salesperson earn if the sales price is $295,000 and the negotiated commission rate was 5.5%?
   a. $1,947
   b. $4,543
   c. $6,490
   d. $6,815

24. A home warranty on an existing home is determined
   a. by standard practices in the area.
   b. by the terms of the contract with the company.
   c. per federal and state law.
   d. by the zoning of the home.

25. If a new home has major issues after one year, generally the buyers will be covered
   a. only if they purchased a new home warranty.
   b. only if the home builder offers warranties.
   c. under state or local laws.
   d. if the damage is more than $100,000.

26. The contract that allows a property manager to screen tenants and collect rent is a
   a. lease agreement.
   b. gross lease.
   c. management agreement.
   d. exclusive right-to-sell listing agreement.

27. A brokerage firm that hires salespersons as independent contractors should supply them with
   a. set work schedules.
   b. paid vacations.
   c. notice of the brokerage firm’s withholding for taxes.
   d. an agreement that the salespersons may set their own hours.

28. The brokerage firm has received an earnest money deposit on a listing. The brokerage firm should
   a. deposit it in the firm’s operations account.
   b. deposit it within five days.
   c. hold the earnest money until the lender sends notice to deposit.
   d. follow the terms of the purchase contract for depositing.

29. What duties does a listing agent owe to a third party buyer?
   a. Fairness and disclosure of benefits and risks
   b. Honesty, fairness, and disclosure of material facts
   c. Honesty, confidentiality, and fairness
   d. Disclosure of material facts, honesty, and loyalty

30. Which of these is FALSE in regard to Sherman Antitrust Act?
   a. A group of brokerage firms cannot make agreements to avoid using a certain title company.
   b. Commissions may be set by the brokerage firm and then negotiated by a company broker or salesperson with a buyer or seller.
   c. Commissions are typically set by the MLS and boards of REALTORS® then finalized by the brokerage firm.
   d. A group of brokerage firms may not make agreements to only list properties in certain territories.
UNIT 9 QUIZ ANSWERS

1. a The listing broker is the agent for the seller.
2. b Under an exclusive right-to-sell listing, the broker is paid regardless of who procured the buyer.
3. d One party's change of heart does not terminate a listing without liability, unless the other party is also willing to terminate it. The seller would still owe the broker a commission if the terms of the listing were fulfilled.
4. b Fiduciary agreements create the representation obligations of agents to principals.
5. c The broker must not discriminate.
6. b Commission rates are determined through negotiation.
7. a Under an exclusive agency listing, owners retain the right to sell the property on their own without compensating the listing broker.
8. c In an exclusive right-to-sell listing, the broker is entitled to be paid if the property is sold during the listing period, regardless of who obtains the buyer.
9. b This clause, which may be referred to as the protection, safety, extension, or holdover clause, protects the broker's commission for up to six months after the listing terminates.
10. a A property manager is a general agent of the property owner. The relationship is ongoing and allows the property manager to bind the property owner to leases.
11. a In an open listing the broker must be the procuring cause of the buyer buying.
12. b Trust funds may not be placed in the broker's business account.
13. c As a fiduciary of the seller, the broker has the duties of obedience, loyalty, disclosure, confidentiality, accountability, and reasonable care and skill (OLD CAR). However, these fiduciary duties do not require or permit the broker to commit fraud or violate anti-discrimination laws.
14. b Licensees must reveal all material facts they know or reasonably should know.
15. d Closing costs are estimated upon presentation of an offer, not in the listing agreement.
16. a A property manager is the agent (fiduciary) of the property owner.
17. d Acting as if you are someone's agent can create an agency by implication.
18. b Regardless of the seller's instructions, agents may be guilty of misrepresentation if they fail to disclose a material fact about the condition of the property.
19. a The law of agency specifies fiduciary obligations to the principal, including loyalty, confidentiality, disclosure, obedience, reasonable care and skill (diligence), and accounting.
20. c An open listing is one in which the broker who brings the buyer will get paid.
21. a The first obligation of a property manager is to maintain the property so that it can make a profit. The manager would do this by finding high quality tenants and hiring good contractors.
22. c $19,560 ÷ $325,000 = 0.06 = 6%
23. b $295,000 × 0.055 × 0.4 × 0.7 = $4,543
24. b The length and terms of a new home warranty are created by contract between the purchaser and the warranty company.
25. c New home construction warranties are created at the state and local level.
26. c The agreement that gives property managers general agency obligations and allows them to screen tenants and collect rent is the management agreement.
27. d Independent contractors must have an agreement stating that they may set their own hours.
28. d The broker is obligated to follow the contract to determine when and where to deposit earnest money. If the contract does not specify, then state law would be followed.
29. b A listing agent owes a third party honesty and fairness, and must disclose material facts. Agents must disclose benefits and risks to the principal, not to a third party.
30. c Commissions may not be set by law, the MLS, or anyone outside the brokerage firm. The brokerage firm may set commissions and policies that allow company brokers or salespersons to then negotiate commissions with buyers and sellers.
Study Plan

Before Class:
Review Units 1–9 using the National Concepts Final Exam Review on the following pages.

During Class:
Complete the Final Exam.

After Class:
Complete the true/false questions in your National Exam Prep book (see instructions in that book).


**NATIONAL CONCEPTS FINAL EXAM REVIEW**

Review the following concepts to prepare for the final exam:

- **Legal descriptions**
  - Metes and bounds
  - Governmental survey
  - Lot block/subdivision

- **Freehold estates**
  - Fee simple absolute
  - Fee simple defeasible
  - Life estates

- **Leasehold estates**
  - Tenancy for years
  - Periodic/month to month
  - At will
  - Tenancy at sufferance
  - Eviction

- **Tenancy**
  - Tenants in common
  - Joint tenants
  - Common interest ownership

- **Encumbrances**
  - Easements
  - Deed restrictions
  - Liens
  - Encroachments

- **Marketable title**
  - Abstract with a title opinion
  - Title insurance
  - Suit to quiet title

- **Appraisal**
  - Market value versus market price
  - Principles of value
  - Market data, cost, and income approaches

- **Finance**
  - Mortgage/deed of trust
  - Loan clauses
  - Types of loans
  - Loan terms
  - Interest calculations
  - Foreclosure

- **Contracts**
  - Essential elements
  - Types of contracts
  - Termination of contracts
  - Earnest money
  - Valid, voidable, and void
  - Material facts
- Deeds
  - Essential elements
  - Types of deeds
  - Warranties and promises

- Consumer protection laws
  - Truth in Lending Act
  - RESPA

- Fair housing
  - Protected classes
  - Steering
  - Blockbusting
  - Redlining

- Agency
  - Fiduciary obligations
  - Exclusive right-to-sell listing
  - Exclusive agency listing
  - Open listing
  - Property management
  - Warranties

- Taxes
  - 1031 exchanges
  - Deductions on income tax returns
UNIT 1 FILL-INS: THE NATURE, DESCRIPTION, AND USE OF REAL ESTATE

I. REAL ESTATE/REAL PROPERTY

A. Key points
   2. Real property includes land plus appurtenances that benefit the land.
      a) Appurtenances are attached to and run with the land.

B. Land
   1. Surface rights
   2. Subsurface rights
   3. Air rights

C. Improvements
   1. Items attached to the land with the intent of being permanent
      a) Examples: house, fence, road, landscaping

D. Rights
   b) Water rights
      (1) The government controls water rights and grants permits for the beneficial use of water, such as irrigation, under the doctrine of prior appropriation.
          a) Riparian—flowing water (R = river)
          b) Littoral—standing water (L = lake)
      c) Mineral rights (subsurface rights)
         (2) They are often held by a third party.

3. Real estate—transferred by a deed
II. PERSONAL PROPERTY (CHATTEL)

A. Key points

1. All property that is not real property
   a) is not permanently attached to the land, and
   b) typically does not transfer with the real estate.
      (1) Must be included in the purchase agreement to convey with the property

2. Personal property is transferred by a bill of sale.

III. LAW OF FIXTURES

A. Fixture

1. A fixture is an object that was once personal property that has been attached to an improvement so as to become real property.

2. Land is never a fixture.

3. Once the fixture (personal property) is attached, it becomes an appurtenance and is automatically transferred in the deed.

B. Test for intent

1. Was the object affixed or installed with the apparent intent of improving the land?

2. Intent is evidenced by the following:
   a) Attachment
      (2) Built-in = fixture; freestanding = personal property
   b) Adaptation
      (2) Examples: house keys, garage door openers
   c) Agreement
      (1) The written agreement regarding the items is the final decision on what will be conveyed.
      (2) Fixtures must be excluded from the purchase agreement if the seller is not going to convey.

C. Exceptions—personal property

   a) Personal property must be included in writing.
   b) Fixtures must be excluded in writing.

IV. PHYSICAL AND ECONOMIC CHARACTERISTICS OF LAND

B. Economic characteristics

   b) Land is not a liquid asset.
V. LEGAL/FORMAL METHODS OF LAND DESCRIPTION

B. Survey
1. A survey is used to create or confirm a legal description.
   b) It uses monuments, which are visible markers that establish property boundaries.
2. An improvement location certificate (ILC) or mortgage survey locates improvements on the property, but is not used to legally set the property boundaries.
   a) Both will reveal encroachments and zoning violations, such as a setback requirement.

C. Metes and bounds
1. Metes: measures in feet, compass degrees
2. Bounds: shape or boundaries
3. Monuments: fixed objects that serve as reference points for the surveyor when setting boundaries
4. Begins and ends at point of beginning (POB)
   a) It is the only description that uses “starting at or commencing at.”

D. Rectangular (government) survey
4. A range is a vertical row of townships (north-south).
5. A tier is a horizontal row of townships (east-west).
7. A section is 1 mile by 1 mile square and contains 640 acres.
8. An acre contains 43,560 square feet.

E. Recorded map “plat” (see Figure 1.4)
2. A plat is a map showing the location and boundaries of individual lots in a land subdivision.
3. Once the final map is approved, but prior to building, the plat is recorded in the county recorder’s office of the county in which the property is located.
4. This system is most common in urban residential areas.

VI. GOVERNMENT LAND USE CONTROLS

A. Master (comprehensive or general) development plan
3. Master development plans are used to control growth.

B. Land use classifications (set by zoning laws)
   a) Note: A buffer zone is an area of land that separates two significantly different land use zones. Parks and open spaces are often used as buffer zones.
C. Land use restrictions tied to police power

2. All new construction and most renovations require a building permit.
   a) Building permits are used to ensure that property owners are in compliance with building codes.

3. Building codes are primarily concerned with the structural integrity and safety of buildings.

4. Certificates of occupancy (COs) are obtained after fulfilling all the requirements of the building permit.

D. Zoning changes/deviations—how land is used

2. An amendment is a zoning change for an entire area.
   a) Could cause nonconforming use

3. Nonconforming use allows the owner to continue present use that no longer complies with current zoning, which is often known as grandfathered or a grandfather clause.

5. Conditional use or special use permits allow a particular property to be used for a special purpose that is in the public's best interest.
   a) Example: church or day care center in residential zoning

E. Disclosures

2. Brokers and salespeople should explain that it is the buyer's responsibility to verify that
   a) the current zoning use and rules will meet the buyer's needs.

VII. AREA (SQUARE FOOTAGE) AND FRONTAGE (STREET FRONT)

B. Area calculations

1. What is the area of a lot 70 feet by 200 feet?
   \[ A = 70' \times 200' = 14,000 \text{ square feet} \]
   The frontage (street front) is 70'

2. What would the above lot sell for at $3 per square foot plus a $5 premium per front foot?
   a) Area: \[ A = 70' \times 200' = 14,000 \text{ sq. ft.} \]
   b) Selling price:
      \[ 14,000 \text{ square feet} \times$3 \text{ per sq. ft.} = $42,000 \]
      \[ \text{plus} \ 70 \text{ front feet} \times$5 = $350 “premium” \]
      \[ $42,000 + $350 = $42,350 \text{ selling price} \]

C. Determining the price per square foot

2. A property listed for $200,000 has 2,000 square feet. What is the price per square foot?
   a) Solution: list price ÷ square feet
      \[ $200,000 ÷ 2,000 = $100 \text{ per square foot} \]
UNIT 2 FILL-INS: RIGHTS AND INTERESTS IN LAND

I. GOVERNMENTAL RIGHTS IN LAND

A. Police power—public control of land
   1. Right to enact and enforce laws governing land use
   2. Planning, zoning, building codes
   3. Determines how land can be developed

B. Eminent domain
   1. Right to “take” private land for public use
   2. Process is called condemnation

C. Taxation—property taxes and special assessments
   2. Taxes have priority over all other liens.
   3. Real property taxes are ad valorem (at assessed value).
      c) Appeals of assessment are first made to a board of appeals
   4. Special assessments are charges against specific properties that benefit from a public improvement.
      a) Found by reading an assessment roll

D. Real property tax calculations
   a) What is the assessed value of a property with an actual value of $425,000 when the state sets the assessment rate at 29%?
      (2) Assessed value = $123,250
   b) What is the annual tax on the property above if the assessed value is $123,250 with a tax rate of $50 per 1,000 (0.050)?
      (3) Step 3: Annual tax = assessed value ($123,250) × tax rate (0.050) = $6,162.50

IV. ESTATES IN LAND

A. Estates
   1. The amount and kind of legal interest in, or right in, real property that allows or will allow possession
   2. Two types
      a) Freehold estates: ownership for an indefinite duration
      b) Leasehold (nonfreehold): possession for a fixed term
B. Rights of ownership: freehold estates

1. Fee simple absolute—complete bundle of rights (also known as fee estate or fee simple)
   a) Maximum or largest control of property
   b) Lasts forever

2. Fee simple defeasible (defeated)—or qualified fee
   a) Created by a deed condition and is normally a gift
   b) If the deed condition is violated, may revert to grantor

3. Life estate
   c) Upon death of the life tenant, the estate returns to fee simple absolute and goes to the party named in the deed, either
      (1) the grantor—reverter, or
      (2) a third party—remainderman.

C. Rights of possession: leasehold estates

1. Key points of leasehold estates
   a) The possession is for a fixed term.

2. Estate (tenancy) for years
   a) Specific termination date—no advance notice required
   b) Death of landlord or tenant does not terminate

3. Periodic estate (tenancy)/estate from period-to-period
   a) Renews automatically for set period upon payment of rent

V. ENCUMBRANCES

A. Key points

1. An encumbrance is any claim, right, or interest held by a party who is not the legal owner of the property; a nonpossessory interest.

4. Buyers should contact an attorney if they have any concerns about an encumbrance, such as an easement, lien, deed restriction, or encroachment.

B. Definition of an easement

1. The right to use the lands of another for a specific purpose

C. Types of easements

1. Appurtenant easement has a dominant tenement and a servient tenement.
   a) Transfers with the land
Appendix

175

b) Does not increase dominant estate’s size, but may increase its value
   (a) Driveway across a neighbor’s land for ingress and egress

2. Easement in gross has no dominant property, only servient property.
   b) Example: Utility easement

3. Easement by necessity is granted by the courts to a private owner to prevent creation of land-locked property; it is only granted if there is no other access. This easement is only available to private owners and not public utilities, railroads, or governments.

4. Easements may be created by express agreement, prescription, or necessity.
   b) Not revocable once given

5. Easements can be terminated three ways.
   (1) Unless the easement is released, it will transfer with the deed

D. Deed restrictions (private controls on real property)

1. Deed restrictions are privately created controls on land use that protect property values and the interests of property owners.

5. Deed restrictions must be for lawful purposes (e.g., cannot restrict property owners based on race or other protected groups).

E. Liens

   a) A lien waiver releases an unrecorded lien.
   b) A recording of a satisfaction releases a recorded lien.

F. Lien types

   1. Specific liens—attach only to specific real or personal property
      (1) Has priority over all other liens
   2. Mortgage liens or deeds of trust (voluntary)
      a) Voluntary pledge of lands to secure payment of debt
   3. General liens—attach to all property, including personal and real property

G. Homestead rights

   1. A homestead exemption is created by state statute to protect a primary residence against creditors.

H. Encroachments

   2. Any buyer who finds an encroachment before or after closing should consult an attorney.

VI. LICENSES

A. Key point

   1. Revocable, unassignable permission that grants privilege to use the property
UNIT 3 FILL-INS: OWNERSHIP AND TITLE TRANSFER

I. FORMS OF OWNERSHIP

A. Sole ownership/estate in severalty
   1. Ownership by an individual is ownership (estate) in severalty.
   2. Upon death, the property goes to the heirs or devisees.
   3. A legal entity can own in severalty.
      c) In a limited partnership, the limited partners’ liability is equal to their share of ownership.

B. Concurrent (multiple) ownership
   1. Definition
      a) In concurrent (multiple) ownership, two or more persons share ownership with undivided interests. Because their shares or interests are fractional but undivided, they have equal rights of possession.
      c) Buyers should obtain an attorney’s advice to determine the most appropriate form of co-ownership.
   2. Tenancy in common: co-ownership without right of survivorship to other owners
      a) Default in most states is tenancy in common with equal shares unless otherwise specified in deed
         (1) With tenancy in common, shares can be unequal
      b) No survivorship—interests go to heirs or devisees upon death
         (2) Each tenant will be responsible for the property taxes as an individual or a group
   3. Joint tenancy: co-ownership with right of survivorship to other owners
      a) Must be specified in deed—“as joint tenants”
      c) Upon death, interests go to co-owner(s) without going through probate
         (1) Overrides a will
      d) Must have four unities
         (1) Possession, interest, title, and time (PITT)

C. Common interest community ownership
   1. Key points
      b) Generally, a common interest community has the authority to levy mandatory assessments on its owners for the maintenance of common elements, typically through homeowners association (HOA) dues.
2. Condominium
   a) Real estate, portions of which are designated for separate ownership (units) and the remainder of which are designated for common ownership and use (common elements)
   c) Created by recording a declaration, which describes the legal and physical structure along with any restrictions on use
      (b) Common elements are owned by all unit owners as tenants in common.
   d) Each unit owner is a member of the homeowners association, a nonprofit with the following functions:
   f) Owners own and finance their individual units independently

4. Cooperative
   (1) No deed; no ownership of unit

5. Time-share
   d) Most common for resort properties

II. CONVEYING OWNERSHIP

A. Act of conveying real estate ownership (title): alienation
   4. A private grant is from individuals, using a deed.
   5. A public grant is from the government to individuals, using a land patent.
   6. A dedication is from individuals to the government.

B. Key points and characteristics of deeds
   2. A seller of real property will always be required to provide a written deed.
   5. Deeds do not guarantee or prove ownership.

C. Essential elements of a valid deed
   1. Competent grantor
      a) 18, sane, and sober
      b) Seller is grantor and buyer is grantee
   4. Delivery to and acceptance by the grantee(s)
      a) Title passes upon acceptance by grantee
   5. Legal description of the land (property description)
      a) Legal descriptions describe only the land—appurtenances are presumed to transfer with the land unless specifically excluded and are not mentioned in the legal description
   6. Consideration
      a) Money or something of value
D. Types of deeds

1. General warranty deed
   a) Includes the most promises or covenants
   b) Greatest protection for the grantee
   c) Contains five covenants and warranties of title
      (1) Covenant of seisin: grantor owns and has right to convey
      (2) Covenant of quiet enjoyment: grantee will not be “disturbed” by others claiming an interest
      (5) Warranty forever: guarantee of defense of title against claims such as liens or easements

2. Special (limited) warranty deed
   a) Only warrants against defects or encumbrances arising during grantor’s ownership
   b) No protection against previous claims

3. Quitclaim deed
   a) Best for the grantor
   b) No covenants or warranties—“What I’ve got, you’ve got”
   d) Would use when grantor wants no future claims or liability

III. CONVEYANCE AFTER DEATH

A. Probate

2. Wills must go through probate in order for the devisee to receive real property.

B. Transfer by will (testate)

1. Devise is the act of transferring a deceased person’s interest in real estate to another deed.
2. Bequest is the act of transferring a deceased person’s interest in personal property to another bill of sale.

IV. OTHER WAYS OF ACQUIRING RIGHTS (IN VOLUNTARY ALIENATION)

A. Key points

1. The law presumes that owners of real property will regularly inspect their property and protect their interest by giving a notice to cease and desist to anyone who is trespassing.
3. Owners who are aware of possession and use by another and have given the possessing/using party permission or license to possess or use do not fall under this law.

B. Adverse possession

1. Ownership recognized by the courts after open, continuous, exclusive, actual, and notorious (hostile) possession of another’s land for a certain period set by state law
C. Easement by prescription/prescriptive easement

1. Easement recognized by the courts after open, continuous, exclusive, actual, and notorious (hostile) use of another’s land for a certain period set by state law
   a) Remember the mnemonic device OCEAN: possession or use must be Open (visible), Continuous, Exclusive (distinct), Actual, and Notorious (hostile)

V. PROPERTY TRANSFER DISCLOSURES

A. Seller’s disclosure statement
   b) Sellers (never the broker) complete the disclosure to the best of their current knowledge.
   c) The seller and the broker must disclose visible and latent material defects (facts) to all buyers.
      (1) A material fact or defect is one that, if known, might change a decision.
      (2) A latent defect is a hidden fact that is not easily discovered by an inspection

UNIT 4 FILL-INS: RECORATION, TITLE INSURANCE, AND SETTLEMENT

I. PUBLIC RECORDING SYSTEM

A. Key points
   1. Policies and procedures that regulate recording are established by state laws. These laws determine who is responsible for organizing and maintaining recorded documents for each state.
   2. Recording does not prove the validity of the document.

C. System allows users to post claims
   1. Gives constructive or legal notice
   2. Establishes priority of interests—“first in time, first in right”

D. System allows users to search claims
   1. Inspect property for visible claims and actual notice, such as parties in possession or encroachments
   2. Inspect public records for constructive notice, such as liens and persons on the title

E. Requirements for recording
   b) A deed that is not recorded lacks constructive notice of ownership.

F. Subordination
   1. Subordination is a clause in a mortgage/deed of trust or agreement in which the lender permits a subsequent mortgage to take or change priority.
      a) Allows mortgages to maintain their original position
II. HOW MARKETABLE TITLE IS DETERMINED

B. Title search
   a) The chain of title is a history of successive ownership documents linked together.

C. Abstract of title and attorney’s opinion of title (see Figure 4.1)
   2. An abstract of title is a historical summary of all recorded documents affecting title to a given parcel of land and is created through a title search.
   3. The seller is expected to furnish an updated abstract, which shows all current and past recorded interests.
   5. After tracing the chain of title, the attorney renders a title opinion.
      b) Lists objections

D. Title insurance
   3. Title report and commitment
      a) The title report states the current condition of the title and is a commitment to insure.
         (1) Shows the current status of recorded encumbrances
         (2) Does not show history of past owners or encumbrances
      b) The commitment lists policy exceptions, which are defects and encumbrances that have been discovered or may exist, and are not covered by the policy.
         (1) Standard exceptions: Items never covered; buyer responsible for checking
         (2) Special exceptions: Clouds specific to the property discovered by examiner

III. TITLE INSURANCE POLICIES

A. Standard coverage policy
   1. A standard coverage policy protects against all problems found after closing.

C. Types of policies
   1. New buyers will receive an owner’s policy, which protects owners/buyers and their heirs while they have an interest.
   2. A mortgagee’s policy protects the mortgagee/lender.

D. Policy premium
   1. Unlike most insurance, the premium for title insurance is paid once when the policy is issued at closing.

IV. SUIT TO QUIET TITLE

B. Notice sent to interested parties
   1. A lis pendens is filed.
C. Court hears and judges claims

2. Once the court order is recorded, the cloud on title is cleared.

V. ENVIRONMENTAL ISSUES—DISCLOSURE REQUIREMENTS VARY BASED ON STATE LAW

A. Key points

1. Most environmental issues fall under the purview of the Environmental Protection Agency (EPA).

3. Environmental issues are considered material facts that must be disclosed by sellers and brokers.

B. Asbestos

4. If a building is being demolished or renovated, abatement (removal) should be done by a licensed professional before demolition.

5. Encapsulation (sealing in place) is often a better choice than removal because there is less of a risk of exposing the fibers.

C. Lead-based paint disclosures

2. Federal law requires sellers of housing built before January 1, 1978, to make a disclosure to buyers, even if a real estate licensee is not involved in the transaction. Brokers must inform sellers of their obligation to perform the following:
   d) Offer buyers a 10-day opportunity to have the home tested
      (1) Buyers may waive the inspection
   e) Sellers are not required to do a lead inspection or removal

3. The listing broker is responsible for making sure that the purchase agreement includes signed acknowledgments by the buyers, the sellers, and all real estate professionals.
   a) Real estate brokers must sign the lead-based paint disclosure in the purchase agreement and are responsible for making sure all parties are in compliance.

D. Radon

1. Radon is a naturally occurring odorless, radioactive gas.

5. Radon is typically mitigated by adding a ventilation system to move the gas outside, which is typically less expensive than solutions for many other environmental issues.

F. Mold

4. Remediation (removal) of mold should be done per EPA and state regulations.

I. Stigmatized properties (psychological impact)

2. State laws determine if or when these issues may be disclosed.
VI. SETTLEMENT/CLOSING PROCEDURES

A. Real Estate Settlement Procedures Act (RESPA)

3. Lenders must give a good-faith estimate of all closing costs (including loan origination and discount points) and a Shopping for Your Home Loan settlement costs booklet at the time of loan application or within three business days of application.

B. Escrow

3. The escrow agent/escrow holder is a disinterested party who assists in carrying out the transaction according to the terms of the purchase contract.

C. Closing statement

2. Debit to buyer is anything that increases the amount of money the buyer must bring to the closing.
   a) Examples: sales price, new loan origination fees, recording the warranty deed, loan origination, or discount points if paid by buyer

3. Credit to buyer is anything that decreases the amount of money the buyer must bring to the closing.
   a) Examples: earnest money, new loan amount (all loans are always a buyer credit), interest on assumed mortgage or seller financing

4. Debit to seller is anything that decreases the amount of money the seller takes from the closing.
   a) Examples: brokerage fee, owner’s title insurance, payoff of existing loan or seller financing

5. Credit to seller is anything that increases the amount of money the seller takes from the closing.
   a) Example: sales price

VII. PRORATION (NATIONAL EXAM)

A. Calculating prorations

3. The prorated amount will always be an equal amount with a debit to one party and a credit to the other.

B. Practice question

b) To find the days the buyer owes, subtract the total days from the seller’s last day: 30 – 20 = 10 days.

UNIT 5 FILL-INS: REAL ESTATE CONTRACTS

I. HOW A CONTRACT IS CREATED

A. Implied contract

1. Actions indicate intent
B. Express (declared) contract

1. Can be oral or written
   a) To be enforceable, the majority of real estate contracts must be express written documents.

3. Unilateral
   b) Only one party is bound

II. CLASSIFICATION OF CONTRACTS

A. Valid

1. Meets all legal requirements; contains all essential elements

C. Voidable

1. A voidable contract appears to be valid, but one party may disaffirm it because the party is a minor or was subject to duress, fraud, or misrepresentation.

III. STAGES OF A CONTRACT

A. Offer

2. The offer may be countered and new offers made until there is a meeting of the minds.

B. Contract

1. All parties must abide by the terms of the contract, or be in breach.

2. In order for the contract terms to be changed, an amendment must be negotiated and signed by all parties.

IV. ESSENTIAL ELEMENTS OF A VALID CONTRACT

A. Contractual capacity/legally competent parties

1. Must be 18 years old or an emancipated minor

2. Must be sane and sober
   a) Persons determined to be incompetent by a judge cannot enter into a contract unless the court authorizes someone to act on their behalf.

B. Mutual agreement/consent/offer and acceptance

1. Offer accepted and communication of acceptance given before the offer is withdrawn
   a) The contract becomes binding upon communication of acceptance.

2. Counteroffer—a change of any conditions in the offer
   a) Legally, a rejection terminates the original offer (but it usually carries forward many terms from the original offer).
4. No fraud or misrepresentation
   a) The parties may not make false statements or omit material facts.
      (1) A material fact is one that, if known, might change a decision and must be disclosed.
   b) This does not include puffing (the act of making a claim that anyone would understand is not literally true).

D. Consideration
   2. Earnest money is not consideration for a sales contract and therefore is not required; earnest money is liquidated damages.

V. STATUTE OF FRAUDS AND STATUTE OF LIMITATIONS
   A. Statute of frauds
      1. The statute of frauds requires that, in order to be enforceable, certain contracts must be in writing and signed by all parties expected to perform.
      2. The statute-of-frauds requirement includes all contracts for the transfer of interests in real estate.

VI. PERFORMANCE AND DISCHARGE
   A. Executory versus executed
      1. Executory—not yet fully performed
   B. Addendum
      1. Additional material attached to and made part of an offer (e.g., disclosures and contingencies)
   C. Amendments/modification
      1. Modification of contract terms by mutual agreement
      2. Must be written and signed by all parties
   D. Assignment
      1. Transfers contract rights, but not liability
   E. Novation
      2. New contract replaces original contract
   H. Mutual rescission
      1. Return of all parties to their original condition before contract was executed (earnest money typically will be returned)

VII. REMEDIES FOR BREACH OF CONTRACT/DEFAULT
   A. How a breach of contract occurs
      c) The statute of limitations sets forth the amount of time that the nonbreaching party has to take legal action against the breaching party.
B. Remedies for the nonbreaching party

1. Acceptance of partial performance
   a) Choose not to sue

2. Specific performance
   a) Sue to force performance—for completion of the contract
   b) Available to both buyer and seller

3. Liquidated damages (available only if specified in the agreement)
   b) Available only to seller in a purchase contract

4. Actual damages
   a) Sue for money lost

VIII. TYPES OF REAL ESTATE CONTRACTS

A. Purchase agreement

1. The offer becomes an executory contract upon communication of acceptance.

3. The parties are the following:
   a) Seller is vendor—holds legal title
   b) Buyer is vendee—holds equitable title (“equitable owner”)

5. The contract typically includes one or more contingency clauses stating that the party will not be responsible for completing the purchase under certain conditions.
   b) If the buyer terminates per a contingency, the earnest money is returned and the contract is terminated.

B. Option

   b) If the buyer decides not to buy, the seller does not have any recourse except to keep the buyer's option fee.

D. Right of first refusal

3. It gives the owner more flexibility than an option because there is typically no set price and the seller can sell to others if the first right is not exercised.

F. Lease

3. Parties
   a) Landlord = lessor
   b) Tenant = lessee

7. Types of leases
   a) Gross/fixed: tenant pays fixed rent and landlord pays all expenses
b) Commercial leases include the following:

1. Net: tenant pays base rent plus expenses (e.g., property taxes, insurance, maintenance)

2. Percentage: rent based on a percentage of gross income/sales; most typical in retail properties

4. Ground (land): used to rent unimproved property
   (b) Tenant would want a long-term lease if adding improvements.

8. Termination of lease based on expiration date of lease or required notice
   (1) Expiration date (not death)

■ UNIT 6 FILL-INS: APPRAISAL

Appreciation and Depreciation Calculations

Question 1: A property purchased three years ago for $200,000 has appreciated 16%. What is its current value?

Per = 100% + 16% = 116%  \[ B = 200,000 \]
A = Per × B = 1.16 × 200,000 = $232,000

Question 2: A property recently appraised for $275,000. Since it was purchased, it has appreciated 10%. What was the original purchase price?

A = $275,000  \[ Per = 100% + 10% = 110% \]
B = A ÷ Per = 275,000 ÷ 1.10 = $250,000

Question 3: A property has a current value of $210,000. It has depreciated 25% since it was purchased two years ago. What was the original value?

A = $210,000  \[ Per = 100% – 25% = 75% \]
B = A ÷ Per = 210,000 ÷ 0.75 = $280,000

I. APPRAISAL

A. Definition of an appraisal

1. An estimate or opinion of market value supported by an analysis of relevant property data

C. Purpose and function of appraisals

a) An appraisal is required for all federally related loans, such as conventional, FHA, and VA loans from regulated lenders; it is not required for seller-carry loans.

D. CMA/BPO/broker opinion of value (BOV)

4. A broker may charge a fee for the CMA/BPO/BOV, but should make it clear that it is not an appraisal.

II. VALUE

A. Market value

1. The most probable price (in terms of cash or its equivalent) that a property should bring when
B. Market price
   1. Actual sales price or what someone actually paid

C. Essential elements of value (DUST)
   1. Demand
   2. Utility (usefulness)
   3. Scarcity
   4. Transferability

III. PRINCIPLES OF VALUE
A. Highest and best use
   3. The appraiser must show current highest and best use in the appraisal.

C. Supply and demand
   2. Supply: number of available properties (of a certain type in a certain area)
      a) Price moves opposite of supply; when supply goes up, price goes down.
   3. Demand: number of properties that will be purchased
      a) Price moves with demand; when demand goes up, price goes up.
   4. Determines sale prices and rental rates

D. Substitution
   2. It is the basis of the sales comparison approach and is used in all three approaches.

E. Conformity
   2. Regression is when the value of overimproved property declines.
   3. Progression is when the value of underimproved property increases.

F. Contribution
   3. Increasing returns are improvements that add more value than they cost.
   4. Decreasing returns are improvements that add less value than they cost.

IV. METHODS OF VALUATION
A. Sales comparison/market data approach
   3. Subject property
      b) Never adjust the subject
   4. Comparable sales (comps)
      b) Adjustments are always made to the sold comparables to make them similar to the subject.
c) The comparables with the least adjustments generally give a stronger indication of value.
   (1) In a rapidly changing market, comparables that have sold within 6 months and up to 12 months should be used.

5. Primary elements of comparison and adjustment
   b) Date of sale (values may be appreciating or depreciating)

6. Adjustments are made to the comps
   (1) If comp is better than subject, subtract
   (2) If comp is worse than subject, add

B. Cost approach

1. Key points
   a) It is the most important method for new construction and unique or special-purpose properties, such as churches and schools.

2. Three steps in cost approach
   (1) Land does not depreciate, so its value must be deducted from the improvements that depreciate.

3. Cost to build new (uses only one of these methods)
   a) Reproduction cost new
      (1) Cost to build a replica with same or highly similar material
   b) Replacement cost new
      (1) Cost to replace improvements with the same functionality/utility

4. Categories of depreciation
   a) Key points
      (1) Depreciation is a loss of value for any reason.
   b) Physical deterioration (also called obsolescence)
      (2) Wear and tear
   d) Economic obsolescence (also called locational obsolescence or external obsolescence)
      (2) Outside the property boundaries

5. Appreciation and depreciation calculations
   b) Question: A property purchased three years ago for $200,000 has appreciated 16%. What is its current value?
      \[ \text{Per} = 100\% + 16\% = 116\% \]
      \[ \text{B} = $200,000 \]
      \[ \text{A} = \text{Per} \times \text{B} = 1.16 \times $200,000 = $232,000 \]
C. Income approach

1. Key point
   a) The income approach is used for properties that generate income, such as an apartment building, shopping center, or office building.

2. Investment properties
   b) Investors determine what they will pay based on a rate of return or capitalization rate.

3. Capitalization
   a) Process of converting estimated future income into present value
   d) Capitalization math
      (1) Example 1: If a property’s annual net income is $10,000 and the investor desires a return of 10%, what would the investor be willing to pay?
         \[ \frac{10,000}{0.10} = 100,000 \]
      (2) Example 2: An investor offers $400,000 for a property and expects to earn a rate of return of 6%. How much was the net operating income?
         \[ I = 400,000 \times 0.06 = 24,000 \]
      (3) Example 3: The net operating income for a property is $18,000. An investor offered $300,000 for it. What would be the rate of return?
         \[ I = \frac{18,000}{300,000} = 6\% \]

V. RECONCILIATION

A. Key points
   2. Each approach is weighted and used to determine a subject’s estimated value. It is not an average.

UNIT 7 FILL-INS: MORTGAGES, DEEDS OF TRUST, AND LENDING PRACTICES

I. FINANCING DOCUMENTS

B. Promissory note
   1. Legal instrument that evidences the debt that is secured by the mortgage or deed of trust
   4. Special provisions
      (1) If borrower defaults, lender can demand immediate payment of entire balance

C. Mortgage or deed of trust (security instruments)
   2. Mortgage or deed of trust creates a lien
      b) Interest on the majority of home loans is simple, not compounded
4. Mortgage: two-party instrument
   a) Borrower is the mortgagor who gives the mortgage to the lender
   b) Lender is the mortgagee (see Figure 7.6)
5. Deed of trust: three-party instrument (see Figure 7.7)
   b) Lender is the beneficiary (benefits from the trust)

D. Provisions of a mortgage/deed of trust
4. Due-on-sale clause—also called alienation clause
   a) Provides that when the property is sold, the lender may demand immediate repayment of entire debt

E. Reasons for loan acceleration and foreclosure
5. Waste—would include deferred maintenance that lowers value below what is owed

II. MISCELLANEOUS MORTGAGE TERMS

B. Equity
   1. Market value today
      – Total debt today
      = Equity

D. Discount points
   3. Lender charges points to increase yield on a loan

III. FORECLOSURE—GOVERNED BY STATE LAWS

A. Key points
   1. Foreclosure is a procedure whereby title to property used as security for a debt is taken by a creditor/lender and sold to satisfy the debt.
      a) The foreclosure process removes all liens from the property.

D. Foreclosure sale process (for most states)
   1. Equitable redemption period: right to stop foreclosure
      a) The borrower cures by paying missed payments, plus interest and penalties.
   4. Lender sells the real estate owned (REO) property after statutory redemption period to satisfy the debt
      b) Insufficient sale proceeds may result in a deficiency or personal judgment to the lender.

IV. DEED IN LIEU OF FORECLOSURE AND SHORT SALE

A. Deed in lieu of foreclosure (alternative to foreclosure)
   2. It does not wipe out secondary liens.
V. METHODS OF PRINCIPAL AND INTEREST (DEBT SERVICE) PAYMENT

A. Term (straight) loan
   1. Interest-only payments until maturity or at end of term
   2. Entire principal paid back in one lump sum balloon payment

E. Budget mortgage
   2. PITI: Principal, interest, taxes, and insurance

I. Reverse mortgage—for seniors (was called a reverse annuity)
   1. Mortgagee pays the mortgagor

J. Home equity loan
   1. Truth in Lending Act (Regulation Z) requires all home equity loans to have a three-day right of rescission

VI. SUBPRIME AND PREDATORY LENDING

A. Subprime loans
   1. In subprime loans, a higher-than-prime rate is charged because the borrower and/or property used as security is a higher risk than a prime borrower (e.g., prime rate might be 6%, while subprime is 8%).

VII. SELLER FINANCING

B. Contract for deed
   1. A contract for deed is also known as a land contract or an installment contract.

■ UNIT 8 FILL-INS: GOVERNMENT LOAN PROGRAMS, INCOME TAXES, AND FAIR HOUSING

I. CONVENTIONAL LOANS

B. Insured conventional mortgages
   1. A buyer (borrower/mortgagor) pays PMI when the LTV is above 80%.
   2. Private mortgage default insurance protects lenders from loss due to a deficiency, which would occur after a foreclosure.
      a) PMI does not pay off the full loan.
      c) The advantage for the borrower is a smaller down payment.

II. GOVERNMENT FINANCING PROGRAMS

A. FHA-insured loan program (Federal Housing Administration)
   1. FHA provides its own mortgage default insurance.
      a) It insures the lender against loss due to borrower default.
2. Loan funds come from approved lenders, not FHA.
   b) The properties must be owner-occupied.

3. FHA traditionally has permitted a higher loan-to-value ratio than conventional mortgage loan programs.

4. There is no prepayment penalty.
   a) Loan payoff will be based on the original loan terms.

**B. VA-guaranteed loan program (Department of Veterans Affairs)**

1. The VA guarantees lenders against losses on loans to eligible veterans.
   (1) Does not include parents of veterans

2. The veteran must occupy the property as a home.

3. No down payment is required and the loan-to-value ratio can be up to 100%.

4. VA requires the following two certificates:
   a) Certificate of eligibility/entitlement

**III. SOURCES FOR REAL ESTATE LOANS**

**B. Primary mortgage market**

1. Mortgage bankers provide financing; they are direct lenders.

2. Mortgage brokers bring together borrowers and lenders.
   a) Act as intermediaries

**C. Secondary mortgage market**

1. Secondary market activities
   a) In the primary market, real estate loans are originated.
   b) In the secondary market, existing mortgages are bought from banks to provide capital to the primary mortgage and lending process.
   d) If their mortgage is sold on the secondary market, borrowers may be directed to send payments to a different address or company, but their loan terms do not change.

2. Three main organizations
   a) FNMA: government-sponsored corporation that buys all types of mortgages (Federal National Mortgage Association—Fannie Mae)
IV. CONSUMER PROTECTION LAWS

B. Truth in Lending Act (Federal Reserve Regulation Z)

1. Purpose: to promote the informed use of consumer credit by requiring advance disclosures of loan terms and costs.
   a) Four primary disclosures required of lenders
      (1) The true cost of obtaining credit is expressed as the loan’s APR; it is not the same as the interest rate.
      (b) The APR will be higher than the “face rate” or “nominal interest rate.”
   b) Applies only to charges paid by the borrower to the lender
      (1) Does not disclose all closing costs
   c) Does not include payments to third parties (i.e., title insurance, legal fees, appraisal, credit report)

2. Right of rescission
   a) Requires a three-day right of rescission for refinances of owner-occupied, one- to four-unit properties and home equity loans
      (1) Rescission does not apply to home purchase or construction loans.

3. Advertising requirements
   b) Information about the down payment, interest rate, monthly payments, or number of payments triggers the full disclosure requirement (the small print).
   c) General statements (e.g., “low down payment” or the amount of property taxes or HOA dues) that are not related to financing are allowed.

4. Remember
   a) Truth in Lending Act = lender costs
   b) RESPA = all costs

V. INCOME TAXATION AND HOMEOWNERSHIP

A. Deductions on a first or second residence

4. Some loan origination fees
   a) Remember POIT: points, origination, interest, and taxes are deductible

5. Must use an itemized tax return to take deductions

C. Taxation of gain on sale of principal residence

1. Gain from the sale of a principal residence is excluded from tax.
   a) $250,000 maximum if single taxpayer
   b) $500,000 maximum if married and filing jointly
2. The taxpayer must own and occupy for at least two of the five years prior to the sale.

D. Depreciation

■ Cost recovery

2. Real estate investors and business property owners may take a depreciation allowance on real estate improvements they own (land does not depreciate).
   a) The residential rental property allowance is \(27.5\) years.
   b) The commercial property allowance is \(39\) years.

3. The amount is determined by the straight-line method.

E. 1031 tax-deferred exchanges (also called like-kind exchanges)

1. 1031 exchanges are used by investors and business property owners to defer payment of capital gains taxes on investment properties.

VI. FAIR HOUSING LAWS

B. Federal Fair Housing Act/Civil Rights Act of 1968

1. Protected classifications in the sale and rental of residential property
   (1) Added in 1988, it protects any family with dependent children under the age of 18. It also includes pregnant women and those fighting for child custody.

2. Classifications that are not protected
   b) Age
   c) Marital status

3. Exemptions
   b) Real estate brokers and salespeople may not discriminate for any reason or in any situation.
   c) All advertising must be in compliance with the law; there are no exemptions.
      (1) All media used to advertise housing, including online blogs and social media, fall under this rule.
   d) It is not unlawful to discriminate based on religion, color, sex, national origin, familial status, or handicap/disability in the following situations:
      (1) Rental or sale of a single-family home by the owner (FSBO)
      (5) Senior housing is allowed to refuse occupancy in rental or sale of units to families with children if the senior housing has at least \(80\)% of the units occupied by at least one person aged 55 or older

4. Prohibitions
   (4) Steering—channeling potential buyers to or away from particular areas as a means of discrimination
   (5) Blockbusting—also called panic selling
(6) **Redlining**—refusing to offer or limiting loans in certain areas because of crime rates or the ethnic background of its residents

5. Disability defined
   a) A disability is any physical or mental impairment that substantially limits one or more major life activity.

6. Property management issues
   2) Landlords may not charge an extra damage deposit.
   4) Landlords are not required to rent to disabled tenants who have a history of violence.

7. Complaints
   c) Complaints can be filed directly in federal court within two years.
   1) The first step is for HUD or the state to investigate the complaint.

10. Protect against claims of discrimination by keeping all records (e.g., all showings, disclosures)

**D. Equal Credit Opportunity Act (ECOA)**

3. ECOA adds the protected classes of marital status, age, and public assistance.

**E. Americans with Disabilities Act (ADA)**

2. A public accommodation is any private entity with facilities open to the public, such as a real estate office.

5. Disabled residential tenants may make modifications at their expense. They must return the unit to its original condition.

**VII. ETHICS FOR REAL ESTATE PROFESSIONALS**

**B. Disclosure and practicing within levels of competence**

1. All real estate professionals are expected to know when they are not competent to perform a task. This includes the following:

**D. National Do Not Call Registry**

2. Brokers and salespeople may contact consumers for three months after the consumer has made an inquiry.

3. Brokers and salespeople may call consumers with whom they have “an established business relationship” for up to 18 months after the last purchase.

**UNIT 9 FILL-INS: AGENCY AND LISTINGS**

**I. THE ROLES AND RESPONSIBILITIES OF THE BROKERAGE FIRM**

**A. The broker and brokerage firm**

   a) All contracts, listings (employment), and purchase agreements
B. The role of the salesperson/broker associate

2. Can be an employee or independent contractor
   (1) must withhold taxes, but
   b) Independent contractors (employed by the firm) must
      (1) have a signed independent contractor agreement stating that
         (a) they may set their own work hours, and

II. AGENCY RELATIONSHIPS

A. Parties to an agency relationship

1. Principal: one who employs another to act on her behalf; may or may not be the person who pays the agent

B. Common law of agency specifies fiduciary duties to principal (OLD CAR)

1. Obedience
   a) An agent must obey the lawful directions of the principal.

2. Loyalty

3. Disclosure

4. Confidentiality
   a) An agent must keep the principal’s confidential information private.
      (1) Must keep price, terms, and motivation (PTM) confidential forever
   b) An agent may release confidential information with permission from the principal.

5. Accounting

6. Reasonable skill and care

D. Scope of an agent’s authority

1. Special agency is created when an agent is authorized to perform a particular act without the ability to bind the principal (in an advisory capacity only).
   a) Listing brokerage firm to seller
   b) Buyer brokerage firm to buyer

2. General agency is created when an agent is authorized to perform a series of acts associated with the continued operation of a particular business. The agent has a limited ability to bind the principal.
   a) Salesperson or broker associate to employing broker
   b) Property manager to property owner
3. Universal agency is created when an agent is authorized to perform in place of the principal. The agent has unlimited ability to bind the principal.
   a) The agent’s authority comes from a legal form called a power of attorney, which creates an attorney-in-fact.
   b) The agent legally replaces the principal.
      (1) Can accept/reject offers and sign for principal

E. Creation of agency
1. Agency is determined by who employs the agent, not who pays the agent.
2. An express agreement is created by a direct statement; may be called a fiduciary agreement.

F. Single agency/dual agency/transaction-broker/facilitator
2. Dual agency occurs when a broker represents more than one party to a transaction. The licensee will have limited duties of disclosure.
   a) Typically requires disclosure and written consent of both parties

III. BROKERAGE RELATIONSHIP DISCLOSURE REQUIREMENTS (REQUIRED BY ALL STATES)
A. Key points
1. Each state typically requires a brokerage relationship disclosure form to be provided to the consumer (seller or buyer) at first substantive contact and before the broker associate receives any confidential information.

IV. SHERMAN ANTITRUST LAW
B. Price-fixing: illegal and not allowed
2. All fees and commissions charged to the public are always negotiable.
3. Each brokerage firm sets its own rates.
   c) Brokers may not discuss commissions with any brokers outside of their firm.
4. Commissions are not set by law or agreement among brokerage firms, MLS systems, broker associates, REALTOR® associations, or the state licensing authority.

V. AGENCY AGREEMENTS/BROKERAGE AGREEMENTS
A. Listing (fiduciary) agreement (specific content determined by state law)
1. Parties
   a) Seller = principal/client
   b) Brokerage firm = agent/fiduciary
2. Elements of a listing agreement
   d) “Negotiable commission” clause
      (1) Commissions are always negotiable, as required by the Sherman Antitrust Act.
e) Define **beginning and expiration** dates

f) Multiple-listing clause
   
   (2) Listing brokerage and broker represent the **seller**
   
   (3) Buyer's brokerage and broker represent the **buyer**

h) Signatures
   
   (1) Listing agreement must be signed by all **property owners** to be valid for the sale of the entire property.

3. Types of listings
   
   (a) Even if the **seller** sells the property

b) Exclusive agency
   
   (1) Brokerage gets paid if property sells, unless the seller finds the buyer

c) Open/nonexclusive
   
   (1) Only the brokerage who finds (procures) the buyer gets paid

**D. Additional broker obligations to all parties**

5. Hold trust funds (other people's money) in a trust account
   
   a) If a brokerage firm accepts and holds funds that belong to others (i.e., **earnest money**, security deposits, rents, taxes, insurance, escrow payments, and unearned commissions), then the brokerage firm and employing broker are required to maintain an account for the deposit of trust funds.

   c) Licensees must follow requirements when handling earnest money.

   (2) The managing or employing broker of the listing firm **must** deposit the funds in a trust account.

   (b) The account must be a **demand account**, which freely allows for the deposit and withdrawal of funds.

   e) The commingling of funds is prohibited. Real estate professionals cannot **mix** personal funds or the firm's funds with trust funds.

   f) **Conversion** is when trust funds are used for personal reasons or given to the wrong people.

**E. Property management agreement**

2. The parties to the agreement are the following:
   
   a) Property owner—**principal**

   b) Property manager (brokerage firm)—**general agent**

   (1) Broker associates and salespeople may not be a party or sign without the **employing broker's** knowledge.
3. The manager's responsibilities in the agreement are financial, physical, and administrative management to do the following:
   a) Maintain the value of the property
   b) Generate income from the property

VI. WARRANTIES

A. Home warranty programs – cover existing homes
   3. The terms and length are determined by the contract with the warranty company.

B. New home construction warranties
   b) Does not cover structural damage from outside forces

VII. BROKERAGE FEES (SALES COMMISSIONS)

B. Example 1: Calculating a sales commission
   \[ C = 0.06 \times 80,000 = 4,800 \]

C. Example 2: Sales price
   a) Commission divided by the rate: \( 4,800 \div 0.06 = 80,000 \)
Glossary

abandonment Failure to occupy and use property, which may result in a loss of rights.

abstract of title A short account of what appears in the public record affecting the title of a particular parcel of real property; ordinarily includes a chronological summary of all grants, conveyances, wills, transfers, and judicial proceedings that have in any way affected title, together with all liens and other encumbrances of record, showing whether or not they have been released.

abut To touch, border on, be adjacent to, or share a common boundary with.

acceleration clause Provision in a promissory note or security instrument that allows the lender to declare the entire debt due immediately if the borrower breaches one or more provisions of the loan agreement or is in default in paying on the loan. Also referred to as a call provision.

acceptance 1. Agreeing to the terms of an offer to enter into a contract, thereby creating a binding contract. 2. Taking delivery of a deed from the grantor.

accretion A gradual addition to dry land by the forces of nature, as when waterborne sediment is deposited on waterfront property.

acknowledgment When a person who has signed a document formally declares to an authorized official (usually a notary public) that he signed voluntarily. The official can then attest that the signature is voluntary and genuine (without duress).

acquisition cost The sum required to obtain title to a piece of property. In addition to the purchase price, it typically includes an appraisal fee, title insurance costs, and other closing costs paid by the buyer.

acre An area of land is equal to 43,560 square feet. There are 640 acres in a section of land.

actual age The age of a structure from a chronological standpoint (as opposed to its effective age); how many years it has actually been in existence.

actual notice Actual knowledge of a fact, as opposed to knowledge imputed by law (constructive notice).

adaptation Used to determine if something is a fixture. If the item is attached and has been adapted to the property, it is most likely a fixture.

addendum Additional information attached to a contract at the time the agreement is formed. It may add contractual provisions or provide information.

adjacent Nearby, next to, bordering, or neighboring; may or may not be in actual contact.

adjustable-rate mortgage (ARM) A loan in which the interest rate is periodically increased or decreased to reflect changes in the cost of money. Compare: fixed-rate.

administrator A person appointed by the probate court to manage and distribute the estate of a deceased person, when no executor is named in the will or there is no will.

ad valorem A Latin phrase that means “according to value,” used to refer to taxes that are based on the value of property.

adverse possession Acquiring title to real property that belongs to someone else by taking possession of it without permission, in the manner and for the length of time prescribed by statute.

affirm 1. To confirm or ratify. 2. To make a solemn declaration that is not under oath.

agency A relationship of trust created when one person (the principal) grants another (the agent) authority to represent the principal in dealings with third parties.

agency by estoppel When third parties are given the impression that someone who has not been authorized to represent another is that person’s agent, or else given the impression that an agent has been authorized to perform acts that are, in fact, beyond the scope of the agent’s authority. Also called ostensible or apparent agency.

agency, dual See: dual agency.

agent A person authorized to represent another (the principal) in dealings with third parties.

agent, general See: general agent.

agent, special See: special agent.

agent, universal See: universal agent.

air rights The right to undisturbed use and control of the airspace over a parcel of land; may be transferred separately from the land.

alienation The transfer of ownership or an interest in property from one person to another, by any means.
alienation, involuntary  Transfer of an interest in property against the will of the owner, or without action by the owner, occurring through operation of law (e.g., a mortgage foreclosure), natural processes, or adverse possession.

alienation, voluntary Voluntary transfer of an interest in property from one person to another.

alienation clause A provision in a security instrument (mortgage or deed of trust) that gives the lender the right to declare the entire loan balance due immediately if the borrower sells or otherwise transfers the security property. Also called a due-on-sale clause.

amendment to a contract An amendment is a mutually agreed change to an existing agreement. It can change the terms or the original contract.

amenities Features of a property that contribute to the pleasure or convenience of owning it, such as a fireplace, a beautiful view, or its proximity to a good school.

Americans with Disabilities Act (ADA) A federal law enacted to assure access to “places of public accommodation” for the disabled. It applies to places of business and public services.

amortization Gradual repayment of a debt with installment payments that include both principal and interest, over a set period of time. See also: loan, amortized.

amortization, negative The addition of unpaid interest to the principal balance of a loan, thereby increasing the amount owed.

annexation Attaching personal property to real property, so that it becomes part of the real property (a fixture) in the eyes of the law. See also: fixture.

annual percentage rate (APR) All the charges that the borrower will pay for a loan (including the interest, origination fee, borrower-paid discount points, and mortgage insurance costs), expressed as an annual percentage of the loan amount.

appraisal An estimate or opinion of the value of a piece of property by an appraiser as of a particular date. Also called valuation.

appraiser One who estimates the value of property, especially an expert qualified to do so by training and experience. State and federal laws require appraisers to be licensed.

appreciation An increase in value; the opposite of depreciation.

appropriation, prior See: prior appropriation.

appurtenance Anything that is incident to, attached to, or pertains to the land, but is not necessarily a part of it. An appurtenance is ordinarily transferred with the land, but some appurtenances may be transferred separately.

appurtenant easement See: easement appurtenant.

APR See: annual percentage rate.

area 1. Locale or region. 2. The size of a surface, usually in square units of measure, such as square feet or square miles.

ARM See: adjustable-rate mortgage (ARM).

arm’s length transaction 1. A transaction in which both parties are informed of the property’s merits and shortcomings, neither is acting under unusual pressure, and the property has been exposed on the open market for a reasonable length of time. 2. A transaction in which there is no preexisting family or business relationship between the parties.

assemblage Combining two or more adjoining properties into one tract.

assessment appeal A property owner’s appeal to a board of assessment appeals regarding the valuation of property for tax purposes.

assessor An official who determines the value of property for taxation.

asset Anything of value that a person owns.

assets, liquid Cash and other assets that can be readily turned into cash (liquidated), such as stock. Real estate is not considered a liquid asset.

assign 1. (verb) To transfer rights (especially contract rights) or interests to another. 2. (noun) A successor in interest to property, other than an heir. See also: heirs and assigns.

assignee One to whom rights or interests have been assigned.

assignment 1. A transfer of contract rights from one person to another. 2. In the case of a lease, the transfer by the original tenant of his or her entire leasehold estate to another. Compare: sublease.

assignor One who has assigned a right or interest to another.

associate broker (broker associate) A common term for a licensee who holds a broker license and is employed by and supervised by an employing broker or managing broker.

assume To take on legal responsibility for a debt or other obligation that was formerly the responsibility of another.

assumption When a property buyer takes on personal liability for paying off the seller’s existing mortgage.

assumption fee A fee paid to the lender, usually by the buyer, when a mortgage is assumed.
attachment  Court-ordered seizure of property belonging to a defendant in a lawsuit, so that it will be available to satisfy a judgment if the plaintiff wins. In the case of real property, attachment creates a lien.

attachments, natural  Plants growing on a piece of land, such as trees, shrubs, or crops. See: emblements.

attorney-in-fact  Any person authorized to represent another created by a power of attorney; not necessarily a lawyer (an attorney-at-law).

auditing  Verification and examination of records, particularly the financial accounts of a business or other organization.

authority, actual  Authority actually given to an agent by the principal, either expressly or by implication.

authority, implied  An agent's authority to do everything reasonably necessary to carry out the principal's express orders.

B

bad debt/vacancy factor  A percentage deducted from a property's potential gross income to determine the effective gross income, estimating the income that will probably be lost because of vacancies and tenants who don't pay.

balance sheet  A summary of facts showing the financial condition of an individual or a business, including a detailed list of assets and liabilities. Also called a balance sheet.

balloon payment  A payment on a loan (usually the final payment) that is significantly larger than the regular installment payments.

bankruptcy  1. A situation resulting when the liabilities of an individual, corporation, or firm exceed the assets. 2. Declaration by a court that an individual, corporation, or firm is insolvent, with the result that the assets and debts are administered under bankruptcy laws.

base line  In the rectangular survey system, a main east-west line from which township lines are established. Each principal meridian has one base line associated with it.

basis  A figure used in calculating a gain on the sale of real estate for federal income tax purposes. Also called cost basis.

basis, adjusted  The owner's initial basis in the property, plus capital expenditures for improvements, and minus any allowable depreciation or cost recovery deductions.

basis, initial  The amount of the owner's original investment in the property; what it cost to acquire the property, which may include closing costs and certain other expenses, as well as the purchase price.

benchmark  A surveyor's mark at a known point of elevation on a stationary object, used as a reference point in calculating other elevations in a surveyed area; often a metal disk set into cement or rock.

beneficiary  1. One for whom a trust is created and on whose behalf the trustee administers the trust. 2. The lender in a deed of trust transaction.

bequeath  To transfer personal property to another by will.

bequest  Personal property (including money) that is transferred by will.

bilateral contract  A contract in which each party has made a binding promise to perform (as distinguished from a unilateral contract).

bill of sale  A document used to transfer title to personal property from one person to another.

binder  1. An agreement to consider an earnest money deposit as evidence of the potential buyer's good faith when she makes an offer to buy a piece of real estate. 2. An instrument providing immediate insurance coverage until the regular policy is issued. 3. Any payment or preliminary written statement intended to make an agreement legally binding until a formal contract has been drawn up.

binding and enforceable  A valid agreement that will obligate both parties to their duties and can be enforced through the court system.

blanket mortgage  A mortgage that covers more than one parcel of property. Commonly contains a partial release clause to release individual properties as the balance is paid down.

blighted area  An area where the real property has declined in value significantly.

block  In a subdivision, a group of lots surrounded by streets or unimproved land.

blockbusting  Attempting to induce owners to list or sell their homes by predicting that members of another race or ethnic group, or people suffering from some disability, will be moving into the neighborhood; this violates antidiscrimination laws. Also called panic selling.

blue laws  Statutes or ordinances restricting the transaction of business or other activities on Sundays and certain holidays.

blue sky laws  Laws that regulate the promotion and sale of securities in order to protect the public from fraud.

board of directors  The body responsible for governing a corporation on behalf of the stockholders, which oversees the corporate management.

bona fide  In good faith; genuine; not fraudulent.
bonus  An extra payment, over and above what is strictly due.

boot  A term used in connection with tax-free exchanges, when the properties exchanged are not equal in value, to refer to whatever is given (i.e., cash, services) to make up the difference in value—for example, in an exchange of real property, if one party gives the other cash in addition to real property, the cash is boot.

boundary  The perimeter or border of a parcel of land; the dividing line between one piece of property and another.

bounds  Boundaries. See also: metes and bounds.

breach  Violation of an obligation, duty, or law; especially an unexcused failure to perform a contractual obligation.

broker, real estate  One who is licensed to represent members of the public in real estate transactions for compensation.

brokerage  A real estate broker's business.

brokerage fee  The commission or other fee charged by a real estate broker for their services.

brokerage firm  A real estate business with an employing or managing broker and broker associates or salespeople.

budget mortgage  A loan in which the monthly payments include a share of the property taxes and insurance, in addition to principal and interest; the lender places the money for taxes and insurance in an escrow account. Sometimes called a PITI loan.

buffer zone  A zoning area between two incompatible zoning areas.

building codes  Regulations that set minimum standards for construction methods and materials.

building restrictions  Rules concerning building size, placement, or type; they may be public restrictions (e.g., zoning ordinance) or private restrictions (e.g., CC&Rs).

bulk transfer  The sale of all or a substantial part of the merchandise, equipment, or other inventory of a business, not in the ordinary course of business.

bulk transfer law  A law requiring a seller who negotiates a bulk transfer (usually in connection with the sale of the business itself) to furnish the buyer with a list of creditors and a schedule of the property being sold, and to notify creditors of the impending transfer.

bundle of rights  The rights inherent in ownership of property, including the right to use, lease, enjoy, encumber, will, sell, or do nothing with the property.

business opportunity  A business that is for sale.

buydown  The payment of discount points to a lender to reduce (buy down) the interest rate charged to the borrower; especially when a seller pays discount points to help the buyer/borrower qualify for financing.

buyer representation agreement  A contract in which a real estate broker agrees to try to locate suitable property for the other party (the buyer) in exchange for a commission.

bylaws  The rules and regulations that govern the operations of a corporation, or of a unit owners' association in a condominium.

cancellation  Termination of a contract without undoing acts that have already been performed under the contract. Compare: rescission.

capacity  The legal ability or competency to perform some act, such as enter into a contract or execute a deed or will. See also: competent.

capital  Money (or other forms of wealth) available for use in the production of more money.

capital assets  Assets held by a taxpayer other than (1) property held for sale to customers in the ordinary course of the taxpayer's business, and (2) depreciable property or real property used in the taxpayer's trade or business. Thus, real property is a capital asset if it is owned for personal use or for profit.

capital expenditures  Money spent on improvements and alterations that add to the value of the property and/or prolong its life.

capital gain  Profit realized from the sale of a capital asset. If the asset was held for more than one year, it is a long-term capital gain; if the asset was held for one year or less, it is a short-term capital gain.

capital improvement  Any improvement that is designed to become a permanent part of the real property or that will have the effect of significantly prolonging the property's life.

capitalization  A method of appraising real property by converting the anticipated net income from the property into the present value. Also called the income approach to value.

capitalization rate  A percentage used in capitalization (net income = capitalization rate × value). It is the rate believed to represent the proper relationship between the value of the property and the income it produces; the rate that would be a reasonable return on an investment of the type in question, or the yield necessary to attract investment of capital in property like the subject property.

capitalize  1. To provide with cash, or capital. 2. To estimate the present value of an asset using capitalization.

capital loss  A loss resulting from the sale of a capital asset; it may be long-term or short-term, depending on whether the asset was held for more than one year, or for one year or less.
cash flow  The residual income after deducting from effective gross income all operating expenses and debt service.

caveat emptor  A Latin phrase meaning “let the buyer beware”; it expresses the idea that a buyer is expected to examine property carefully before buying, instead of relying on the seller to disclose problems. This was once a firm rule of law, but it has lost most of its force, especially in residential transactions.

CC&Rs  A declaration of covenants, conditions, and restrictions; usually recorded by a developer to place restrictions on all lots within a new subdivision.

certificate of eligibility  A document issued by the Department of Veterans Affairs as evidence of a veteran’s eligibility for a VA-guaranteed loan.

certificate of occupancy  A statement issued by a local government agency (such as the building department) verifying that a newly constructed building is in compliance with all building codes and may be occupied.

certificate of reasonable value  A document issued by the Department of Veterans Affairs, setting forth the current market value of a property, based on a VA-approved appraisal.

certificate of sale  The document given to the purchaser at a mortgage foreclosure sale; becomes a sheriff’s deed only after the redemption period expires.

cesspool  An underground pit used to catch and temporarily hold sewage while it decomposes and leaches into the surrounding soil.

chain of title  The chain of deeds (and other documents) transferring title to a piece of property from one owner to the next, as disclosed in the public record; more complete than an abstract.

chattel  An article of personal property.

civil law  The body of law concerned with the rights and liabilities of one individual in relation to another; includes contract law, tort law, and property law. Compare: criminal law.

civil rights  Fundamental rights guaranteed to individuals by the law. The term is primarily used in reference to constitutional and statutory protections against discrimination or government interference.

Civil Rights Act of 1866  A federal law that forbids discrimination on racial grounds in all business transactions. It was upheld by the U.S. Supreme Court in the Jones v. Mayer decision, which reinforced the idea that “racial” applies to discrimination based on ethnic groups.

civil suit  A lawsuit in which one private party sues another private party (as opposed to a criminal suit, in which an individual is sued—prosecuted—by the government).

Clean Air Act  A federal law regulating the emission of air pollutants.

Clean Water Act  A federal law intended to reduce water pollution.

clear title  A good title to property, free from encumbrances or defects; marketable title.

client  One who employs a broker, lawyer, appraiser, or other professional. A real estate broker’s client may be the seller, the buyer, or both.

closing  The final stage in a real estate transaction, when the seller receives the purchase money, the buyer receives the deed, and title is transferred. Also called settlement or escrow.

costs  Expenses incurred in the transfer of real estate in addition to the purchase price—for example, the appraisal fee, title insurance premium, broker’s commission, and state deed tax. Also called settlement costs.

closing date  The date on which all the terms of a purchase agreement must be met, or the contract is terminated.

closing statement  A document that presents a final, detailed accounting for a real estate transaction, listing each party’s debits and credits and the amount each will receive or be required to pay at closing. Also called a settlement statement.

cloud on title  A claim, encumbrance, or apparent defect that makes the title to a property unmarketable. See also: title, marketable.

code of ethics  A body of rules setting forth accepted standards of conduct, reflecting principles of fairness and morality—especially one that the members of an organization are expected to follow.

codicil  An addition to or revision of a will.

collateral  Anything of value used as security for a debt or obligation.

collusion  An agreement between two or more persons to defraud another.

color of title  Title that appears to be good title, but which in fact is not; commonly based on a defective instrument, such as an invalid deed.

commercial property  Property zoned and used for business purposes, such as a restaurant or an office building; as distinguished from residential, industrial, or agricultural property.

commingling  Illegally mixing trust funds held on behalf of a client with personal funds.
commission  1. The compensation paid to a broker for services in connection with a real estate transaction (usually a percentage of the sales price). 2. A group of people organized for a particular purpose or function; often a governmental body.

commitment  In real estate finance, a lender's promise to make a loan. A loan commitment may be "firm" or "conditional"; a conditional commitment is contingent on something, such as a satisfactory credit report on the borrower.

commitment, title insurance  The binding promise from a title insurance company to insure the merchantability of title based on restrictions and exceptions listed in the title report.

common areas  1. In a building with leased units or spaces, the areas that are available for use by all the tenants. 2. The common elements in a condominium.

common elements  The land and improvements in a condominium or other common interest development that are owned and used collectively by all the residents, such as parking lots, hallways, and recreational facilities available for common use. Also called common areas.

common elements, limited  Common elements that are reserved for the use of a certain unit or certain units, to the exclusion of other units; examples include assigned parking spaces and storage lockers.

common interest ownership  The form of ownership that is involved in condominiums, town houses, cooperatives, and time-shares.

common law  1. Early English law. 2. Long-established rules of law based on early English law. 3. Rules of law developed in court decisions, as opposed to statutory law. 4. A law requiring that when an offeree accepts a contract, the agreement is not binding on all parties until that acceptance has been communicated to the offeror.

communication of acceptance  A concept of contract law requiring that when an offeree accepts a contract, the agreement is not binding on all parties until that acceptance has been communicated to the offeror.

community property  In certain states, property owned jointly by a married couple, as distinguished from each spouse's separate property; generally, any property acquired through the labor or skill of either spouse during marriage.

competent  1. Of sound mind, for the purposes of entering into a contract or executing a legal instrument. 2. Both of sound mind and having reached the age of majority.

compliance inspection  A building inspection to determine, for the benefit of a lender, whether building codes, specifications, or conditions established after a prior inspection have been met before a loan is made.

concurrent ownership  Shared ownership of one piece of property by two or more individuals, each owning an undivided interest in the property with equal rights of possession (as in a tenancy in common or joint tenancy). Also called multiple ownership, co-ownership.

condemnation  1. Taking private property for public use through the government's power of eminent domain. 2. A declaration that a structure is unfit for occupancy and must be closed or demolished.

condition  1. A provision in a contract that makes the parties' rights and obligations depend on the occurrence (or nonoccurrence) of a particular event. See also: contingency clause. 2. A provision in a deed that makes title depends on compliance with a particular restriction.

conditional use permit  A permit that allows a special use, such as a school or hospital, to operate in a neighborhood where it would otherwise be prohibited by zoning. Also called a special use permit or special exception permit.

condominium  Property developed for common interest ownership, where each co-owner has a separate interest in an individual unit, combined with an undivided interest in the common elements of the property.

condominium association  The unit owners association of a condominium. See also: unit owners association (HOA).

confirmation of sale  Court approval of a sale of property by an executor, administrator, or guardian.

conforming loan  A loan made in accordance with the standardized underwriting criteria of the major secondary market agencies, Fannie Mae and Freddie Mac, and which therefore can be sold to those agencies.

conformity, principle of  See: principle of conformity.

conservation  1. Preservation of structures or neighborhoods in a sound condition. 2. Preservation or controlled use of natural resources for long-term benefits.

conservator  A person appointed by a court to take care of the property of another who is incapable of taking care of it on her own.

consideration  Anything of value given to induce another to enter into a contract, such as money, goods, services, or a promise. Sometimes called valuable consideration. See also: love and affection.

conspiracy  An agreement or plan between two or more persons to perform an unlawful act.

construction mortgage  A loan to finance the cost of constructing a building, usually providing that the loan funds will be advanced in installments as the work progresses. Also called an interim loan.

constructive  Held to be so in the eyes of the law, even if not so in fact. See also: constructive eviction; constructive notice.
constructive eviction  The legal concept that if a landlord does something or fails to perform a duty and the result is that a property is no longer fit for the lessee's intended use, the lessee may move out and be relieved of future obligations under the lease.

constructive notice  Knowledge of a fact imputed to a person by law. People are held to have constructive notice of something when they should have known it (because they could have learned it through reasonable diligence or an inspection of the public record), even if they did not actually know it.

Consumer Price Index  An index that tracks changes in the cost of goods and services for a typical consumer. Formerly called the cost of living index.

consummate  To complete.

contiguous  Adjacent, abutting, or in close proximity.

contingency clause  A provision in a contract that makes the parties' rights and obligations depend on the occurrence (or nonoccurrence) of a particular event. Examples: inspection, appraisal and loan commitment.

contour  The shape or configuration of a surface. A contour map depicts the topography of a piece of land by means of lines (contour lines) that connect points of equal elevation.

contract  An agreement between two or more persons to do or not do a certain thing, for consideration.

contract, bilateral  See: bilateral contract.

contract, executed  See: executed contract.

contract, executory  See: executory contract.

contract, express  See: express contract.

contract, implied  See: implied contract.

contract, oral  See: oral contract.

contract, real estate  See: real estate contract.

contract, sales  See: purchase agreement.

contract, unenforceable  See: unenforceable contract.

contract, unilateral  See: unilateral contract.

contract, valid  See: valid contract.

contract, void  See: void contract.

contract, voidable  See: voidable contract.

contract for deed  A form of seller financing. A contract for the sale of real property in which the buyer (the vendee) pays in installments; the buyer takes possession of the property immediately, but the seller (the vendor) retains legal title until the full price has been paid. Also called a conditional sales contract, installment sales contract, or land contract. See also: seller financing.

contract of sale  See: purchase agreement.

contractor  One who contracts to perform labor or supply materials for a construction project, or to do other work for a specified price. A general contractor is in charge of a construction project, which she carries out with the assistance of subcontractors.

contribution, principle of  See: principle of contribution.

conventional financing/mortgage  An institutional loan that is not insured or guaranteed by a government agency. May require private mortgage insurance. Also called a conventional loan.

conversion  Misappropriating property or funds belonging to another; for example, converting trust funds to one's own use.

conveyance  The transfer of title to real property from one person to another by means of a written document, especially a deed.

cooperative  A form of common interest ownership. A cooperative building is owned by a corporation, and the residents are shareholders in the corporation; each shareholder receives a proprietary lease on an individual unit and the right to use the common areas.

co-ownership  Shared ownership of one piece of property by two or more individuals, each owning an undivided interest in the property with equal rights of possession (as in a tenancy in common or joint tenancy). Also called multiple ownership.

corporation  An association organized according to certain laws, in which individuals may purchase ownership shares; treated by the law as an artificial person, separate from the individual stockholders.

correlation  The final step in an appraisal, when the appraiser assembles and interprets the data in order to arrive at a final value estimate. See also: reconciliation.

cost  The amount paid for anything in money, goods, or services.

cost approach to value  One of the three main methods of appraisal, in which an estimate of the subject property's value is arrived at by estimating the cost of replacing (or reproducing) the improvements, then deducting the estimated accrued depreciation and adding the estimated market value of the land.

cost basis  See: basis.

cost of living index  See: Consumer Price Index.

counteroffer  A response to a contract offer, changing some of the terms of the original offer; it operates as a rejection of the original offer (not as an acceptance). Also called qualified acceptance. The original offeror becomes the offeree and the original offeree is the new offeror.
covenant 1. A contract. 2. A promise. 3. A guarantee (express or implied) in a document such as a deed or a lease. 4. A restrictive covenant.

covenant, restrictive A promise to do or not do an act relating to real property, especially a promise that runs with the land; usually an owner's promise not to use property in a specified manner.

covenant against encumbrances In a deed, a promise that the property is not burdened by any encumbrances other than those that are disclosed in the deed. See also: general warranty deed.

covenant of further assurance In a deed, a promise that makes the grantor responsible for any further acts necessary to make sure title is clear. See also: general warranty deed.

covenant of quiet enjoyment A promise that a grantee's or a tenant's possession will not be disturbed by the previous owner, the lessor, or anyone else making a lawful claim against the property. See also: general warranty deed.

covenant of seisin In a deed, a promise that the grantor actually owns the interest being conveyed to the grantee and has the right to convey it. See also: general warranty deed.

CPM Certified Property Manager; a property manager who has satisfied the requirements set by the Institute of Real Estate Management of the National Association of REALTORS®.

credit A payment receivable (owed to someone), as opposed to a debit, which is a payment due (owed by someone). At closing, represents money that the party will not have to bring.

creditor One who is owed a debt.

creditor, secured A creditor with a security interest in or a lien against specific property; if the debt is not repaid, the secured creditor can repossess the property or (in the case of real estate) foreclose on the property and collect the debt from the sale proceeds.

criminal law The body of law under which the government can prosecute an individual for crimes, wrongs against society. Compare: civil law.

cul-de-sac A dead-end street, especially one with a semi-circular turnaround at the end.

customer From the point of view of a seller's real estate agent, a prospective property buyer.
deed, correction  A deed used to correct minor mistakes in an earlier deed, such as the misspelling of a name or an error in the legal description of the property. A quitclaim deed is often used for this purpose.

deed, general warranty  A deed in which the grantor warrants the title against defects that might have arisen before or during the grantor’s period of ownership.

deed, gift  A deed that is not supported by valuable consideration; often lists “love and affection” as the consideration.

deed, grant  A deed that uses the word “grant” in its words of conveyance and carries certain implied warranties.

deed, limited (special) warranty  A deed in which the grantor warrants title only against defects that may have arisen during his or her period of ownership. Also called a special warranty deed.

deed, quitclaim  See: quitclaim deed.

deed, sheriff’s  See: sheriff’s deed.

deed, special warranty  See: special (limited) warranty deed; deed, limited (special) warranty.

deed, tax  A deed given to a purchaser of property at a tax foreclosure sale.

deed, trust  See: deed of trust.

deed, trustee’s  A deed given to a purchaser of property at a trustee’s sale, in the nonjudicial foreclosure of a deed of trust.

deed, warranty  1. A general warranty deed. 2. Any type of deed that carries warranties.

deed in lieu of foreclosure  A deed given to a mortgage borrower to the lender to satisfy the debt and avoid foreclosure.

deed of reconveyance  The instrument used to release the security property from the lien created by a deed of trust when the debt has been repaid.

deed of trust  An instrument that creates a voluntary lien on real property to secure the repayment of a debt, and which includes a power of sale clause permitting nonjudicial foreclosure; the three parties are the grantor or trustor (borrower), the beneficiary (the lender), and the trustee (a neutral third party).

deed restrictions  Provisions in a deed that restrict use of the property, and which may be either covenants or conditions (CC&Rs).

default  Failure to fulfill an obligation, duty, or promise, as when a borrower fails to make payments, or a tenant fails to pay rent. May result in acceleration of a loan or eviction from leased property.

default judgment  See: judgment, default.

defeasance clause  A clause in a mortgage or lease that cancels or defeats a certain right upon the occurrence of a particular event. It typically defeats the lien right of the mortgagor when the note has been paid in full.

defeasible fee  See: fee simple defeasible.

defendant  1. The person being sued in a civil lawsuit. 2. The accused person in a criminal lawsuit.

deferred maintenance  Depreciation resulting from maintenance or repairs that were postponed, causing physical deterioration of the building.

deficiency judgment  See: judgment, deficiency.

delivery  The legal transfer of a deed from the grantor to the grantee, which results in the transfer of title. Acceptance by the grantee is an essential part of the delivery process.

demand  Desire to own coupled with ability to afford; in appraisal, this is one of the four elements of value, along with scarcity, utility, and transferability.

demise  The transfer of an estate or interest in property to another for years, for life, or at will.

density  In land use law, the number of buildings or occupants per unit of land.

deposit  Money offered as an indication of commitment or as a protection, and which may be refunded under certain circumstances; for example, a buyer’s earnest money deposit or a tenant’s security deposit.

deposit receipt  See: purchase agreement.

depreciable property  In the federal income tax code, property that is eligible for cost recovery deductions because it will wear out and have to be replaced.

depreciation  1. A loss in value (caused by deferred maintenance, functional obsolescence, or economic obsolescence). 2. For the purposes of income tax deductions, apportioning the cost of an asset over a period of time.

depreciation, accrued  Depreciation that has built up or accumulated over a period of time.

depreciation, age-life  A method of estimating depreciation for appraisal purposes, based on the life expectancy of the property, assuming normal maintenance.

depreciation, curable  Deferred maintenance and functional obsolescence that would ordinarily be corrected by a prudent owner, because the correction cost could be recovered in the sales price.

depreciation, incurable  Deferred maintenance, functional obsolescence, or economic obsolescence that is either impossible to correct, or not economically feasible to correct because the cost could not be recovered in the sales price.
depreciation, straight-line  A method of calculating depreciation for income tax or appraisal purposes, in which an equal portion of a structure's value is deducted each year over the anticipated useful life; when the full value of the improvement has been depreciated, its economic life is exhausted.

depreciation deductions  Under the federal income tax code, deductions from a taxpayer's income to permit the cost of an asset to be recovered; allowed only for depreciable property that is held for the production of income or used in a trade or business. Also called cost recovery deductions.

detached residence  A home physically separated from the neighboring home(s), not connected by a common wall.

developed land  Land with man-made improvements, such as buildings or roads.

developer  One who subdivides or improves land to achieve its most profitable use.

development  1. Any development project, such as a new office park. 2. A housing subdivision. 3. In reference to a property's life cycle, the earliest stage, also called integration.

devise  1. (noun) A gift of real property through a will. 2. (verb) To transfer real property by will. Compare: bequest; bequeath; legacy.

devisee  Someone who receives title to real property through a will. Compare: beneficiary; legatee.

devisor  A testator who devises real property in a will.

disbursements  Money paid out or expended.

disclaimer  A denial of legal responsibility.

discount points  A percentage of the principal amount of a loan, collected by the lender at the time a loan is originated, to give the lender an additional yield.

discount rate  The interest rate charged when a member bank borrows money from the Federal Reserve Bank.

discrimination  Treating people unequally because of their race, religion, sex, national origin, or some other fundamental characteristic.

domicile  The state where a person has a permanent home.

donative intent  The intent to transfer title immediately and unconditionally; required for proper delivery of a deed.

double-entry bookkeeping  An accounting technique in which an item is entered in the ledger twice, once as a credit and once as a debit; used for some settlement statements.

down payment  The part of the purchase price of property that the buyer is paying in cash; the difference between the purchase price and the financing.

downzoning  Rezoning land for a more limited use.

drainage  A system to draw water off land, either artificially (e.g., with pipes) or naturally (e.g., with a slope).

dual agency  When an agent represents both parties to a transaction, as when a broker represents both the buyer and the seller with their written consent.

due-on-sale clause  A provision in a security instrument (mortgage or deed of trust) that gives the lender the right to declare the entire loan balance due immediately if the borrower sells or otherwise transfers the security property. Also called an alienation clause.

duplex  A structure that contains two separate housing units, with separate entrances, living areas, baths, and kitchens.

duress  Unlawful force or constraint used to compel someone to do something (such as sign a contract) against his will.

dwelling  A building or a part of a building used or intended to be used as living quarters.

earnest money  A deposit that prospective buyers give sellers as evidence of their good faith intention to complete the transaction. Also called a good-faith deposit.

earnest money agreement  See: purchase agreement.

easement  An irrevocable right to use some part of another person's real property for a particular purpose.

easement, access  An easement that enables the easement holders to reach and/or leave their property (the dominant tenement) by crossing the servient tenement. Also called an easement for ingress and egress.

easement, prescriptive  See: prescriptive easement.

easement appurtenant  An easement that benefits a piece of property, the dominant tenement. Compare: easement in gross.

easement by necessity  1. A special type of easement by implication, created by law even when there has been no prior use, if the dominant tenement would be entirely useless without an easement. 2. Any easement by implication.

easement by prescription  See: easement, prescriptive

easement in gross  An easement that benefits a person or entity instead of a piece of land; there is a servient tenement, but no dominant tenement. Compare: easement appurtenant.
ECOA (Equal Credit Opportunity Act)  A federal law prohibiting discrimination in the granting of consumer credit based on a set of protected classes. This law adds “age” to the protected groups in addition to the groups protected by fair housing laws.

economic life  The period during which improved property will yield a return over and above the rent due to the land itself; also called the useful life. Compare: physical life.

economic obsolescence  See: obsolescence, economic.

economic survey  A part of the land use planning process, in which the present and anticipated future economic needs of an area are analyzed.

effective age  The age of a structure indicated by its condition and remaining usefulness (as opposed to its actual age). Good maintenance may increase a building's effective age, and poor maintenance may decrease it; for example, a 50-year-old home that has been well maintained might have an effective age of 15 years, meaning that its remaining usefulness is equivalent to that of a 15-year-old home.

effective gross income  See: income, effective gross

egress  A means of exiting, a way to leave a property; the opposite of ingress. The terms ingress and egress are most commonly used in reference to an access easement.

EIS  See: environmental impact statement (EIS).

elements of comparison  In the market data approach to value, considerations taken into account in selecting comparables and comparing comparables to the subject property; they include time of sale, location, and physical characteristics.

emblems  Crops that are produced annually through the labor of the cultivator, such as wheat.

emblems, doctrine of  The legal rule that gives an agricultural tenant the right to enter the land to harvest crops after the lease ends.

eminent domain  The government’s constitutional power to take (condemn) private property for public use, as long as the owner is paid just compensation.

employee  Someone who works under the direction and control of another. Compare: independent contractor.

encroachment  A physical intrusion onto neighboring property, usually due to a mistake regarding the location of the boundary.

encumber  To place a lien or other encumbrance against the title to a property.

encumbrance  A nonpossessory interest in real property; a right or interest held by someone other than the property owner, which may be a lien, an easement, or a restrictive covenant.

derendorsement  Assignment of a negotiable instrument (such as a check or a promissory note) by the payee to another party, by signing on the back of the instrument.

dependent contractor  Someone who works under the direction and control of another. Compare: independent contractor.

dependent contractor  Someone who works under the direction and control of another. Compare: independent contractor.

derependent contractor  Someone who works under the direction and control of another. Compare: independent contractor.

environmental impact statement (EIS)  A report that contains detailed information concerning how a proposed project would affect the environment in the future.

EPA  Environmental Protection Agency.

equitable interest or title  See: title, equitable.

equitable redemption  See: redemption, equitable right of.

equity  1. An owner's unencumbered interest in her property; the difference between the value of the property and the liens against it. 2. A judge's power to soften or set aside strict legal rules, to bring about a fair and just result in a particular case.

erosion  Gradual loss of soil due to the action of water or wind.

escalator clause  A clause in a contract or mortgage that provides for payment or interest adjustments (usually increases) if specified events occur, such as a change in the property taxes or in the prime interest rate. Also called an escalation clause.

escape clause  A provision in a purchase agreement that allows the buyer to terminate the contract if the appraised value of the property turns out to be significantly less than the agreed price. Required for transactions to be financed with FHA or VA loans, if the loan applicant (the buyer) signs the purchase agreement before the appraisal report is issued.

escheat  Reversion of property to the state after a person dies intestate and no heirs can be located.

escrow  An arrangement in which something of value (such as money or a deed) is held on behalf of the parties to a transaction by a disinterested third party (an escrow agent) until specified conditions have been fulfilled.

escrow account  A bank account maintained by a lender for payment of property taxes and insurance premiums on the security property; the lender requires the borrower to make regular deposits, and pays the expenses out of the account. Also called a reserve account or impound account.

estate  1. An interest in real property that is or may become possessory; either a freehold or a leasehold. 2. The property left by someone who has died.

estate, fee simple  See: fee simple absolute.

estate, periodic  See: estate from period to period.
estate at sufferance  A situation in which a tenant who originally took possession of the property lawfully stays on after the lease ends without the landlord's consent; the lowest estate in land. Also called a tenancy at sufferance.

estate at will  A leasehold estate for an indefinite period, which continues until either the landlord or the tenant gives notice of termination to the other party.

estate in remainder  See: remainder.

estate for life  A freehold estate that lasts only as long as a specified person lives; that person is referred to as the measuring life. Commonly called a life estate.

estate for years  An estate for a definite period of time, which terminates automatically at the end of the period. Also called a tenancy for years or a term tenancy.

estate from period to period (periodic tenancy)  A leasehold that by its terms renews automatically for identical periods on the same terms until one party gives notice. There is no set termination date. Month-to-month or quarter-to-quarter leases would be examples.

estate of inheritance  An estate that can pass to the holder's heirs, such as a fee simple.

estoppel  A legal doctrine that prevents a person from asserting rights or facts that are inconsistent with his earlier actions or statements.

estoppel certificate  A document that prevents the person who signs it from later asserting facts different from those stated in the document—for example, a statement signed by a mortgage lender confirming that the remaining mortgage balance is a specified amount. Also called an estoppel letter.

ethics  A system of accepted principles or standards of moral conduct. See also: code of ethics.

eviction  Dispossession or expulsion of a person from real property. See also: unlawful detainer.

eviction, actual  Physically forcing someone off of real property (or preventing them from re-entering), or using the legal process to make them leave. Compare: eviction, constructive.

eviction, constructive  See: constructive eviction.

eviction, self-help  The use of physical force, a lock-out, or a utility shut-off to evict a tenant, instead of the legal process. This is generally illegal.

exception, title insurance  A condition of the title to a property that the title insurance company will not cover. An existing encumbrance or limitation identified by the title insurer and for which the company provides no insurance protection.

exchange  See: tax-free exchange.

exclusive listing  See: listing, exclusive.

exclusive right-to-sell listing  See: listing, exclusive right-to-sell.

exculpatory clause  A clause in a contract that relieves one party of liability for certain injuries or problems; such a provision is not always enforceable.

execute  1. To sign an instrument and take any other steps (such as acknowledgment) that may be necessary to its validity. 2. To perform or complete. See also: contract, executed.

executed contract  A contract in which both parties have completely performed their contractual obligations.

execution  The legal process in which a court orders an official (such as the sheriff) to seize and sell the property of a judgment debtor to satisfy a lien.

executor  A person named in a will to carry out its provisions.

executory contract  A contract in which one or both parties have not yet completed performance of their obligations.

exemption  A provision holding that a law or rule does not apply to a particular person or group; for example, a person entitled to a tax exemption is not required to pay the tax.

expenses, fixed  Recurring property expenses, such as general real estate taxes and hazard insurance.

expenses, maintenance  Cleaning, supplies, utilities, tenant services, and administrative costs for income-producing property.

expenses, operating  For income-producing property, the fixed expenses, maintenance expenses, and reserves for replacement; does not include debt service.

expenses, variable  Expenses incurred in connection with property that do not occur on a set schedule, such as the cost of repairing a roof damaged in a storm.

express  Stated in words, whether spoken or written. Compare: implied.

extender clause  See: override clause.

external obsolescence  See: obsolescence, economic.

failure of purpose  When the intended purpose of an agreement or arrangement can no longer be achieved; in most cases, this releases the parties from their obligations.

Fannie Mae  Popular name for the Federal National Mortgage Association (FNMA).
feasibility study A cost-benefit analysis of a proposed project, often required by lenders before giving a loan commitment.

Fed The Federal Reserve.

federal Fair Housing Act The 1968 law that makes discrimination based on race, color, sex, religion, or national origin illegal in connection with the sale or rental of most housing. Handicap and familial status were added as protected classes in 1988.

Federal Home Loan Mortgage Corporation (FHLMC) A government-sponsored secondary market agency, popularly known as Freddie Mac.

Federal Housing Administration (FHA) A federal agency within the Department of Housing and Urban Development (HUD) that provides mortgage insurance to encourage lenders to make loans to low- and middle-income homebuyers. See also: loan, FHA.

Federal Land Bank One of 12 institutions that make mortgage loans to qualified borrowers for the purchase of farms, other agricultural lands, livestock, farm machinery, etc.


Federal Trade Commission (FTC) A federal agency responsible for investigating and eliminating unfair and deceptive business practices, which is responsible for enforcement of the Truth in Lending Act.

fee, qualified See: fee simple defeasible

fee simple See: fee simple absolute

fee simple absolute The highest and most complete form of ownership (freehold estate), which is of potentially infinite duration. Also called a fee estate or a fee simple.

fee simple defeasible A fee simple estate often given as a gift, that is subject to termination if a certain condition is not met or if a specified event occurs. Also called a conditional fee, determinable fee, or qualified fee.

FHA Federal Housing Administration. See also: loan, FHA.

FHLMC See: Federal Home Loan Mortgage Corporation.

fiduciary relationship A relationship of trust and confidence, in which one party owes the other (or both parties owe each other) loyalty and a higher standard of good faith than is owed to third parties. For example, an agent is a fiduciary in relation to the principal; husband and wife are fiduciaries in relation to one another.

finance charge Any charge a borrower is assessed, directly or indirectly, in connection with a loan. See also: total finance charge.

financial statement A summary of facts showing the financial condition of an individual or a business, including a detailed list of assets and liabilities. Also called a balance sheet.

financing statement A brief instrument that is recorded to perfect and give constructive notice of a creditor's security interest in an article of personal property. The modern version of a chattel mortgage.

finder's fee A referral fee paid to someone for directing a client or customer to a real estate agent, or for directing a loan applicant to a lender.

first lien position The position held by a mortgage that has higher lien priority than any other mortgage against the property. Priority is determined by the date and time of recording in the public record.

fiscal year Any 12-month period used as a business year for accounting, tax, and other financial purposes, as opposed to a calendar year.

fixed disbursement plan A construction financing arrangement that calls for the loan proceeds to be disbursed in a series of predetermined installments when various stages of the construction are completed.

fixed-rate loan See: loan, fixed-rate.

fixed term A period of time that has a definite beginning and ending.

fixture An item that used to be personal property but has been attached to or closely associated with real property in such a way that it has legally become part of the real property. See: annexation, actual


forbearance An agreement in which one of the parties agrees to not do something.

foreclosure Sale of property initiated by a lien holder, against the owner's wishes, so that the unpaid lien can be satisfied from the sale proceeds.

foreclosure, judicial 1. The sale of property pursuant to court order to satisfy a lien. 2. A lawsuit filed by a mortgagor to foreclose on the security property when the mortgagor has defaulted. Also called foreclosure by action.

foreclosure, nonjudicial The right given the public trustee to foreclose for the beneficiary of a deed of trust. See: equitable redemption and statutory redemption

foreclosure, strict When a court orders title to mortgaged property to be transferred directly from the defaulting mortgagor to the mortgagee, without a public auction.

foreclosure by action See: foreclosure, judicial

forfeiture Loss of a right or something else of value as a result of failure to perform an obligation or condition.
Franchise A right or privilege granted by a government to conduct a certain business, or a right granted by a private business to use its trade name in conducting business.

Fraud An intentional or negligent misrepresentation or concealment of a material fact, which is relied upon by another, who is induced to enter into a transaction and harmed as a result.

Fraud, actual Intentional deceit or misrepresentation to cheat or defraud another.

Fraud, constructive A breach of duty that misleads the person the duty was owed to, without an intention to deceive.

Freddie Mac Popular name for the Federal Home Loan Mortgage Corporation (FHLMC).

Free and clear Ownership of real property completely free of liens.

Freehold A possessory interest in real property that has an indeterminable duration; it can be either a fee simple or an estate for life. Someone who has a freehold estate has title to the property (as opposed to someone who has a leasehold estate, who is only a tenant).

Frontage The distance a property extends along a street or a body of water; the distance between the two side boundaries at the front of the lot.

Front foot A measurement of property for sale or valuation, with each foot of frontage presumed to extend the entire depth of the lot.

Front money The cash required to get a project or venture underway; includes initial expenses such as attorney’s fees, feasibility studies, loan charges, and a down payment.

Fully amortized loan A loan with equal consecutive payments calculated to pay the accrued loan interest and pay principal with each payment so that at the end of the term the loan is fully paid.

Functional obsolescence Loss in value due to inadequate or outmoded equipment, or as a result of a poor or outmoded design. Items inside the property boundary.

Funding fee A fee charged in connection with a VA-guaranteed loan. The borrower is required to pay the fee to the Department of Veterans Affairs; it may be financed along with the loan amount.

gain Under the federal income tax code, that portion of the proceeds from the sale of a capital asset, such as real estate, that is recognized as taxable profit.

garnishment A legal process by which a creditor gains access to the funds or personal property of a debtor that are in the hands of a third party. For example, if the debtor’s wages are garnished, the employer is required to turn over part of each paycheck to the creditor.

general agent An agent authorized to handle all of the principal’s affairs in one area or in specified areas. Has a limited power to bind the principal.

general lien A lien against all the assets of a debtor and not specific to any one asset. Judgment liens and income tax liens are general liens.

general warranty deed A grant deed containing the five implied covenants and warranties: covenant of seisin, covenant of quiet enjoyment, covenant against encumbrances, covenant of further assurance, and warranty forever.

gift funds Money that a relative (or other third party) gives to a buyer who otherwise would not have enough cash to close the transaction.

Ginnie Mae Popular name for the Government National Mortgage Association (GNMA).

GNMA See: Ginnie Mae

goodwill An intangible asset of a business resulting from a good reputation with the public, which serves as an indication of future return business.

government lien A lien for property taxes. May be ad valorem taxes or special assessment taxes.

government survey system See: rectangular survey system.

Graduated lease A lease in which it is agreed that the rental payments will increase at certain intervals by a specified amount or according to a specified formula. Two types of graduated leases are a step-up lease or index lease.

Graduated payment mortgage (GPM) A loan that provides for lower payments in the first years of its term; the payments increase in steps, then level off, typically after three to seven years.

grant To transfer or convey an interest in real property by means of a written instrument.

Grantee One who receives a grant of real property.

Granting clause Words in a deed that indicate the grantor’s intent to transfer an interest in property. Also called the words of conveyance.

Grantor One who grants an interest in real property to another.

Gross income multiplier method A method of appraising residential property by reference to its rental value. Also called the gross rent multiplier method.
**Glossary**

**gross lease** A lease in which the rent is set at a fixed amount, and the landlord pays most or all the property's operating expenses. Also called a fixed lease, flat lease, or straight lease.

**gross rent multiplier** A figure that is multiplied by a rental property's gross income to arrive at an estimate of the property's value.

**guardian** A person appointed by a court to administer the affairs of a minor or an incompetent person, who is referred to as the guardian's ward.

**habendum clause** A clause included after the granting clause in many deeds; it begins “to have and to hold” and describes the type of estate the grantee will hold.

**hability, implied warranty of** See: implied warranty of habitability.

**heir** Someone entitled to inherit another's property under the laws of intestate succession.

**heirs and assigns** A phrase used in legal documents to cover all successors to a person's interest in property; assigns are successors who acquire title in some manner other than inheritance, such as by deed.

**highest and best use** The use which, at the time of appraisal, is most likely to produce the greatest net return from the property over a given period of time.

**HOA** Abbreviation for homeowners association.

**holdover clause** A provision in a listing agreement or buyer representation agreement stating that, for a stated period of time, the broker will be entitled to a commission for a sale to a party introduced to the property by the broker. Listing exclusively with a different broker usually terminates holdover rights.

**homeowners association** A nonprofit association made up of homeowners in a subdivision, responsible for enforcing the CC&Rs and managing other community affairs.

**homestead** Real estate that is occupied and used as the principal residence of the owner and the owner's family.

**homestead law** A state law that provides limited protection against creditors’ claims for homestead property.

**Housing and Urban Development, Department of (HUD)** A cabinet-level federal agency that includes the FHA and Ginnie Mae.

**HUD** See: Housing and Urban Development, Department of (HUD)

**hypothecate** To make property security for an obligation without giving up possession of it (as opposed to pledging, which involves surrender of possession).

**implied** Not expressed in words, but conveyed through actions or circumstances. Compare: express

**implied warranty of habitability** A warranty in every residential lease that the property is fit for habitation.

**impound account** See: escrow account

**improvement** A man-made addition to real property such as a house or landscaping.

**improvements, misplaced** Improvements that do not fit the most profitable use of the site; they can be either over-improvements or underimprovements.

**imputed knowledge** Knowledge presumed by law to exist. A principal is presumed to know information communicated to the principal regarding the subject of the agency. Subagents of a primary agent will have imputed knowledge of a primary agent and will be presumed to know what the primary agent knows.

**in equity (ownership in equity)** The holder of equitable title is the "owner in equity."

**income, disposable** Income remaining after income taxes have been paid.

**income, effective gross** A measure of a rental property’s capacity to generate income; calculated by subtracting a bad debt/vacancy factor from the economic rent (potential gross income).

**income, gross** See: income, potential gross.

**income, net operating** See: net operating income.

**income, potential gross** A property's economic rent; the total income it could earn if it were available for lease in the current market, before making any deductions (for bad debts, vacancies, operating expenses, etc.).

**income, residual** The amount of income that an applicant for a VA loan has left over after taxes, recurring obligations, and the proposed housing expense have been deducted from gross monthly income.

**income, spendable** The income that remains after deducting operating expenses, debt service, and income taxes from a property's gross income. Also called net spendable income or cash flow.

**income approach to value** One of the three main methods of determining value, in which an estimate of the subject property's value is based on the net income it produces; also called the capitalization method or investor’s method of appraisal.

**income property** Property that generates rent or other income for the owner, such as an apartment building. In the federal income tax code, it is referred to as property held for the production of income.
insurance, mortgage Insurance that protects a lender against losses resulting from the borrower’s default. Also called mortgage default insurance.

insurance, private mortgage (PMI) Insurance provided by private companies to conventional lenders for loans with loan-to-value ratios over 80 percent.

insurance, title See: title insurance.

insurance, title, extended coverage Title insurance that covers problems that should be discovered by an inspection of the property (such as encroachments and adverse possession), in addition to the problems covered by standard coverage policies.

insurance, title, standard coverage Title insurance that protects against latent title defects (such as forged deeds) and undiscovered recorded encumbrances, but does not protect against problems that would only be discovered by an inspection of the property.

interest 1. A right or share in something (such as a piece of real estate). 2. A charge a borrower pays to a lender for the use of the lender’s money.

interest, compound Interest computed on both the principal and the interest that has accrued on the principal. Compare: interest, simple

interest, future An interest in property that will or may become possessory at some point in the future, such as a remainder or reversion.

interest, interim See: interest, prepaid

interest, prepaid Interest on a new loan that must be paid at the time of closing; covers the interest due for the first month of the loan term. Also called interim interest.

interest, simple Interest that is computed on the principal amount of the loan only (which is the type of interest charged in connection with real estate loans). Compare: interest, compound

interest, undivided A co-owner’s interest, giving her the right to possession of the whole property, rather than to a particular section of it.

interpleader A court action filed by someone who is holding funds that two or more people are claiming. The holder turns the funds over to the court, which resolves the dispute and delivers the money to the party entitled to it.

intestate Without a valid will.

intestate succession Distribution of the property of a person who died intestate to the heirs.

invalid Not legally binding or legally effective; not valid.

inventory A detailed list of the stock-in-trade of a business.
inverse condemnation  A court action by a private landowner against the government, seeking compensation for damage to property as a result of government action.

inverted pyramid  A way of visualizing ownership of real property; in theory, a property owner owns all the earth, water, and air enclosed by a pyramid that has its tip at the center of the earth and extends up through the property boundaries out into the sky.

investment property  Property held as an investment in the expectation that it will appreciate in value.

joint tenancy  Concurrent ownership in which each owner has a right of survivorship interest in the estates of the others. The parties hold equal interests.

joint venture  Two or more individuals or companies joining together for one project or a related series of projects, but not as an ongoing business. Compare: partnership.

judgment  1. A court’s binding determination of the rights and duties of the parties in a lawsuit. 2. A court order requiring one party to pay the other damages.

judgment, default  A court judgment in favor of the plaintiff due to the defendant’s failure to answer the complaint or appear at a hearing.

judgment, deficiency  A personal judgment entered against a borrower in favor of the lender if the proceeds from a foreclosure sale of the security property are not enough to pay off the debt.

judgment creditor  A person who is owed money as a result of a judgment in a lawsuit.

judgment debtor  A person who owes money as a result of a judgment in a lawsuit.

judgment lien  A general lien against a judgment debtor’s property, which enables the judgment creditor to force the sale of the property and collect the judgment from the proceeds if the judgment debtor does not pay.

judicial foreclosure  1. The sale of property pursuant to court order to satisfy a lien. 2. A lawsuit filed by a mortgagee to foreclose on the security property when the mortgagor has defaulted. Also called foreclosure by action.

just compensation  The compensation that the U.S. Constitution requires the government to pay a property owner when the property is taken under the power of eminent domain.

laches, doctrine of  A legal principle holding that the law will refuse to protect those who fail to assert their legal rights within the time period prescribed by the statute of limitations, or (if there is no applicable statute of limitations) within a reasonable time. Based on the doctrine of laches, a contract that was valid may be unenforceable after a period of time.

land  In the legal sense, it is the solid part of the surface of the earth, everything affixed to it by nature or by man, and anything on it or in it, such as minerals and water; real property.

land contract  See: contract for deed.

land lease (ground lease)  A lease of the land only, usually for a long term, to a tenant who intends to construct a building on the property. Also called a ground lease.

landlocked property  A parcel of land without access to a road or highway.

landlord  A landowner who has leased his property to another. Also called a lessor.

landmark  A monument, natural or artificial, set up on the boundary between two adjacent properties, to show the boundary.

latent defects  Defects that are not visible or apparent (as opposed to patent defects).

lawful objective  An objective or purpose of a contract that does not violate the law or a judicial determination of public policy.

lease  A transfer of a leasehold estate from the fee owner (the landlord or lessor) to a tenant (or lessee); a contract in which one party pays the other rent in exchange for the possession (and profits) of real estate. Sometimes called a rental agreement.

lease, escalator  A lease in which the tenant pays a fixed rent based on the landlord’s estimate of annual operating expenses, with any excess expenses charged to the tenant at the end of the year.

lease, fixed  See: gross lease.

lease, graduated  See: graduated lease.

lease, gross  See: gross lease.

lease, ground  See: land lease.

lease, index  See: index lease.

lease, land  See: land lease.

lease, net  See: net lease.

lease, percentage  See: percentage lease.
lease, sandwich  A leasehold interest lying between the property owner’s interest and the interest of the tenant in possession; for example, when a tenant subleases the property to a subtenant, the original tenant’s interest is sandwiched between the interest of the landlord and that of the subtenant.

lease, step-up  A type of graduated lease in which the rent increases are part of the lease document.

leaseback  See: sale-leaseback

leasehold  A possessory interest in real property that has a limited duration. Also called a less-than-freehold estate.

legacy  A gift of personal property by will. Also called a bequest.

legal description  A precise description of a parcel of real property; the three main types of legal descriptions are metes and bounds, rectangular survey, and recorded plat.

legatee  Someone who receives personal property (a legacy) under a will.

lender, institutional  A bank, savings and loan, or similar financial institution that invests other people’s funds in loans; as opposed to an individual or private lender, which invests its own funds.

lessee  One who leases property from another; a tenant.

lessor  One who leases property to another; a landlord.

less-than-freehold  See: leasehold.

leverage  The effective use of borrowed money to finance an investment such as real estate.

levy  To impose a tax.

liability  1. A debt or obligation. 2. Legal responsibility.

liability, joint and several  A form of liability in which two or more persons are responsible for a debt both individually and as a group.

liability, limited  See: limited liability.

liable  Legally responsible.

license  1. Official permission to do a particular thing that the law does not allow everyone to do. 2. Revocable, nonassignable permission to use another person’s land for a particular purpose. Compare: easement.

lien  A nonpossessory interest in real property, giving the lienholder the right to foreclose if the owner doesn’t pay a debt owed to the lienholder; a financial encumbrance on the owner’s title.

lien, attachment  A lien intended to prevent transfer of the property pending the outcome of litigation.

lien, equitable  A lien arising as a matter of fairness, rather than by agreement or by operation of law.

lien, general  A lien against all the property of a debtor, rather than a particular piece of her property. Compare: Lien, Specific.

lien, involuntary  A lien that arises by operation of law, without the consent of the property owner. Also called a statutory lien. A local improvement special assessment is an involuntary lien.

lien, judgment  A general lien against a judgment debtor’s property, which enables the judgment creditor to force the sale of the property and collect the judgment from the proceeds if the judgment debtor does not pay.

lien, materialman’s  A construction lien in favor of someone who supplied materials for a project (as opposed to labor).

lien, mechanic’s  See: mechanic’s lien.

lien, mortgage  See: mortgage lien.

lien, property tax  See: property tax lien.

lien, specific  See: specific lien.

lien, statutory  See: lien, involuntary.

lien, tax  A lien on property to secure the payment of taxes.

lien, voluntary  A lien placed against property with the consent of the owner; a mortgage.

lienholder, junior  A secured creditor whose lien is lower in priority than another’s lien. Priority is based on the date of recording.

lien notice  A written notice from a contractor or sub-contractor informing a property owner that a lien could be enforced against the property if bills for construction labor or materials are not paid.

lien priority  The order in which liens are paid off out of the proceeds of a foreclosure sale. Determined by the date and time of recording for most liens.

lien theory  The theory holding that a mortgage does not involve a transfer of title to the lender, but merely creates a lien against the property in the lender’s favor. Compare: title theory.

life estate  A freehold estate created by deed that lasts only as long as a specified person lives. That person is referred to as the measuring life. Also called an estate for life.

life tenant  Someone who owns a life estate; the person entitled to possession of the property during the measuring life.

like-kind exchange  See: tax-free exchange.

limited common element  Common elements that are reserved for the use of a certain unit or certain units, to the exclusion of other units; examples include assigned parking spaces and storage lockers.
limited liability A situation in which a business investor is not personally liable for all the debts of the business, as in the case of a limited partner or a corporate stockholder.

defined liability company (LLC) A form of business organization that combines certain characteristics of corporations and partnerships; the managing members are not personally liable for the company's obligations.

limited partnership See: partnership, limited.

limited (special) warranty deed A grant deed in which the warranties of title are limited to the grantor's ownership period.

lineal Relating to a line; having only length, without depth. A lineal mile is 5,280 feet in distance.

liquid (liquid asset) An asset that can be quickly sold on an open market. Real estate is not normally considered a liquid asset.

liquidated damages A sum that the parties to a contract agree in advance (at the time the contract is made) will serve as full compensation in the event of a breach.

lis pendens A recorded notice stating that there is a lawsuit pending that may affect title to the defendant's real estate.

listing A written agency contract between a seller and a real estate broker providing that the broker will be paid a commission for finding (or attempting to find) a buyer for the seller's property. Also called a listing agreement.

listing, exclusive Either an exclusive agency listing or an exclusive right-to-sell listing.

listing, exclusive agency A listing agreement that entitles the broker to a commission if anyone other than the seller finds a buyer for the property during the listing term. The seller reserves the right to arrange a sale without the broker's help and not be obligated to pay a commission.

listing, exclusive right-to-sell A listing agreement that entitles the broker to a commission if anyone—including the seller—finds a buyer for the property during the listing term.

listing, net See: net listing.

listing, open See: open listing.

littoral land Land that borders on a stationary body of water (such as a lake, as opposed to a river or stream). Compare: riparian land.

littoral rights The water rights of an owner of littoral land, in regard to use of the water in the lake.

LLC Limited liability company.

loan See: entries under mortgage.

loan, amortized A loan that requires regular installment payments of both principal and interest (as opposed to interest-only payments). It is fully amortized if the installment payments will pay off the full amount of the principal and all of the interest by the end of the repayment period. It is partially amortized if the installment payments will cover only part of the principal, so that a balloon payment of the remaining principal balance is required at the end of the repayment period.

loan, conforming See: conforming loan.

loan, conventional An institutional loan that is not insured or guaranteed by a government agency. May require private mortgage insurance.

loan, FHA A loan made by an institutional lender and insured by the Federal Housing Administration, so that the FHA will reimburse the lender for losses that result if the borrower defaults.

loan, fixed-rate A loan on which the interest rate will remain the same throughout the entire loan term. Compare: mortgage, adjustable-rate.

loan, G.I. See: loan, VA-guaranteed.

loan, guaranteed A loan in which a third party has agreed to reimburse the lender for losses that result if the borrower defaults.

loan, interest-only A loan that requires the borrower to pay only the interest during the loan term, so that the entire amount borrowed (the principal) is due at the end of the term.

loan, interim Construction mortgage.

loan, permanent See: loan, take-out.

loan, seasoned A loan with an established record of timely payment by the borrower.

loan, take-out Long-term financing used to replace a construction loan (an interim loan) when construction has been completed. Also called a permanent loan.

loan, VA-guaranteed See: VA-guaranteed loan.

loan broker A person or company who negotiates loans between borrowers and lenders.

loan correspondent An intermediary who arranges loans of an investor's money to borrowers, and then services the loans.

loan origination fee The administrative fee often charged for setting up a new loan. Sometimes called a loan service fee.

loan-to-value ratio (LTV) The relationship between the loan amount and either the sales price or the appraised value of the property (whichever is less), expressed as a percentage.
lock-in clause  A clause in a promissory note or contract for deed that prohibits prepayment before a specified date, or prohibits it altogether.

lot  A parcel of land; especially, a parcel in a subdivision.

lot and block description  The type of legal description used for platted property; it states the property’s lot number and block number and the name of the subdivision, referring to the plat map recorded in the county where the property is located. Sometimes called a maps and plats or lot, block, and subdivision description.

love and affection  The consideration often listed on a deed when real estate is conveyed between family members with no money exchanged. The law recognizes love and affection as good consideration (as distinguished from valuable consideration, which is money, goods, or services).

LTV  Loan-to-value ratio.

M

MAI  Member of the Appraiser’s Institute. The initials identify a member of the American Institute of Real Estate Appraisers of the National Association of REALTORS®.

majority, age of  The age at which a person becomes legally competent; generally, 18 years old. Compare: minor.

maker  The person who signs a promissory note, promising to repay a debt. Compare: payee.

management agreement  The agreement between a property manager and the owner of the property specifying the duties and authority of the property manager and the method of payment for the services.

manufactured home  A structure that is transportable, is not affixed to real estate, is built on a permanent chassis, and is designed to be used as a dwelling with or without a permanent foundation. Also applies to housing manufactured in components which are shipped to a site and assembled as units.

maps and plats  See: lot and block description.

margin  In an adjustable-rate mortgage, the difference between the index rate and the interest rate charged to the borrower.

marginal land  Land that is of little economic value and barely repays the cost of working it.

marketable title  Title free and clear of objectionable liens, encumbrances, or defects, so that a reasonably prudent person with full knowledge of the facts would not hesitate to purchase the property.

market data approach  One of the three main methods of appraisal, in which the sales prices of comparable properties are used to estimate the value of the subject property. Also called the sales comparison approach.

market price  1. The current price generally being charged for something in the marketplace. 2. The price actually paid for a property. Compare: market value.

market value  The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. (This is the definition from the Uniform Standards of Professional Appraisal Practice.) Sometimes called value in exchange or objective value. Compare: market price.

master development plan  A comprehensive, long-term plan of development for a community, which is implemented by zoning and other laws. Also called a comprehensive plan or a general plan.

material fact  An important fact; one that is likely to influence a decision. Must be disclosed as soon as it is discovered to all parties to an agreement.

maturity date  The date by which a loan is supposed to be paid off in full.

measuring life  See: life estate.

mechanic’s lien  A lien filed by a party who provided labor or materials to improve the property of another. This lien usually takes its priority from the date the labor began or the date materials were delivered.

meeting of minds  See: mutual agreement.

megalopolis  An extensive, heavily populated, continuously urban area, including any number of cities.

merger  1. Uniting two or more separate properties by transferring ownership of all of them to one person. 2. Acquisition by the owner of one parcel of title to one or more adjacent parcels.

meridian, principal  See: principal meridian.

metes  Measurements.

metes-and-bounds description  A legal description that starts at an identifiable point of beginning, then describes the property’s boundaries in terms of courses (compass directions) and distances, ultimately returning to the point of beginning.

mill  One-tenth of one cent; a measure used to state property tax rates in some cases. For example, a tax rate of one mill on the dollar is the same as a rate of one-tenth of 1% of the assessed value of the property.

mineral rights  Rights to the minerals located beneath the surface of a piece of property.

minimum property requirements (MPRs)  A lender’s requirements concerning the physical condition of a building, which must be met before a loan can be approved.
minor A person who has not yet reached the age of majority; generally, a person under 18.

MIP Mortgage insurance premium; especially a premium charged in connection with an FHA-insured loan.

misrepresentation A false or misleading statement. See also: fraud.

MLS Multiple listing service.

monument A visible marker (natural or artificial) used in a survey or a metes-and-bounds description to establish the boundaries of a piece of property.

mortgage An instrument that creates a voluntary lien on real property to secure repayment of a debt; the two parties are the mortgagor (borrower) and mortgagee (lender). Note: If you do not find the specific term you are looking for, check the entries under "loan."

mortgage, adjustable-rate (ARM) See: adjustable-rate mortgage (ARM).

mortgage, balloon A partially amortized mortgage loan that requires a large balloon payment at the end of the loan term.

mortgage, blanket See: blanket mortgage.

mortgage, budget See: budget mortgage.

mortgage, construction See: construction mortgage.

mortgage, first See: first mortgage.

mortgage, graduated payment (GPM) See: graduated payment mortgage (GPM).

mortgage, hard money A mortgage given to a lender in exchange for cash, as opposed to one given in exchange for credit.

mortgage, junior A mortgage that has lower lien priority than another mortgage against the same property. Sometimes called a secondary mortgage.

mortgage, open-end A loan that permits borrowers to reborrow the money they have repaid on the principal, usually up to the original loan amount, without executing a new loan agreement.

mortgage, package A mortgage used in home financing that is secured by certain items of personal property (such as appliances or carpeting) in addition to the real property.

mortgage, purchase money See: purchase money mortgage.

mortgage, satisfaction of See: satisfaction of mortgage.

mortgage, secondary See: mortgage, junior.

mortgage, senior A mortgage that has higher lien priority than another mortgage against the same property; the opposite of junior mortgage.

mortgage, wraparound A purchase money loan arrangement in which the seller uses part of the buyer's payments to make the payments on an existing loan (called the underlying loan); the buyer takes title subject to the underlying loan but does not assume it.

mortgage banker An intermediary who originates and services real estate loans on behalf of investors.

mortgage broker An intermediary who brings real estate lenders and borrowers together and negotiates loan agreements between them.

mortgage company A type of real estate lender that originates and services loans on behalf of large investors (acting as a mortgage banker) or for resale on the secondary mortgage market.

mortgagee A lender who accepts a mortgage as security for repayment of the loan.

mortgagee's policy A policy of title insurance protecting the lender from title defects that could make the loan collateral less valuable.

mortgage lien The lien created by a mortgage.

mortgage loan A loan secured by a mortgage against specified real property.

mortgagor A property owner (usually a borrower) who gives a mortgage to another (usually a lender) as security for payment of an obligation.

multiple listing service (MLS) An organization of brokers who share their exclusive listings.

mutual agreement When all parties freely agree to the terms of a contract, without fraud, undue influence, duress, menace, or mistake. Mutual consent is achieved through offer and acceptance; it is sometimes referred to as a "meeting of the minds." Also called mutuality.

NAR National Association of REALTORS®.

narrative report A thorough appraisal report in which the appraiser summarizes the data and the appraisal methods used, to convince the reader of the soundness of the estimate; a more comprehensive presentation than a form report or an opinion letter.

negligence Failure to exercise reasonable care; conduct that falls below the standard of care that a reasonable person would exercise under the circumstances.

negotiable instrument An instrument containing an unconditional promise to pay a certain sum of money to order or to bearer, on demand or at a particular time. It can be a check, promissory note, bond, draft, or stock. See also: note, promissory.

NEPA National Environmental Policy Act.
net lease  A lease requiring the tenant to pay the property's operating expenses (such as taxes, insurance, maintenance, and repairs), in addition to the rent paid to the landlord.

net listing  A listing agreement in which sellers set a net amount they are willing to accept for the property. If the actual selling price exceeds that amount, the broker is entitled to keep the excess as the commission.

net operating income  The income that is capitalized to estimate the property's value; calculated by subtracting the property's operating expenses (fixed expenses, maintenance expenses, and reserves for replacement) from the effective gross income. (Note that debt service is not subtracted in calculating net income.)

net proceeds  The amount of money a property seller will receive from the sale after all selling costs have been paid.

net worth  An individual's personal financial assets, minus that person's personal liabilities.

nominal interest rate  The interest rate stated in a promissory note. Also called the note rate or coupon rate. Compare: annual percentage rate.

nonagency  An arrangement in which a real estate licensee acts as a facilitator or go-between for a seller and a buyer, without establishing an agency relationship with either party.

nonconforming loan  A loan that does not meet the standardized underwriting criteria of the secondary market. May require the borrower to pay a higher interest rate. See also: loan, conforming.

nonconforming use  A property use that does not conform to current zoning requirements, but is allowed because the property was being used in that way before the present zoning ordinance was enacted.

nonpossessory interest  An interest in property that does not include the right to possess and occupy the property; typically an encumbrance, such as a lien or an easement.

notarize  To have a document certified by a notary public.

notary public  Someone who is officially authorized to witness and certify the acknowledgment made by someone signing a legal document.

note  See: note, promissory.

note, demand  A promissory note that is due whenever the holder of the note demands payment.

note, installment  A promissory note that calls for regular payments of principal and interest until the debt is fully paid.

note, promissory  A written promise to repay a debt; it may or may not be a negotiable instrument.

note, straight (term)  A promissory note that calls for regular payments of interest only, so that the entire principal amount is due in one lump sum at the end of the loan term.

notice, actual  Actual knowledge of a fact, as opposed to knowledge imputed by law (constructive notice).

notice, constructive  See: constructive notice.

notice of default  A notice sent by a secured creditor to the debtor, informing the debtor that the debtor breached the loan agreement.

notice of nonresponsibility  A notice that property owners may record and post on the property to protect their title against mechanics' liens, when someone other than the owner (such as a tenant) has ordered work on the property.

notice of sale  A notice stating that foreclosure proceedings have been commenced against a property.

notice to quit  A notice to a tenant, demanding that the tenant vacate the leased property.

novation  1. The withdrawal of one party to a contract and the substitution of a new party, relieving the withdrawing party of liability. 2. The substitution of a new obligation for an old one.

nuisance  A use of property that is offensive or annoying to neighboring landowners or to the community.

obligatory advances  Disbursements of construction loan funds that the lender is obligated to make (by prior agreement with the borrower) when the borrower has completed certain phases of construction.

obsolescence  Any loss in value (depreciation) due to reduced desirability and usefulness.

obsolescence, economic  Loss in value resulting from factors outside the property itself, such as proximity to an airport. Also called external obsolescence, external inadequacy, or locational obsolescence. Outside the property boundary and incurable.

obsolescence, functional  See: functional obsolescence.

obsolescence, locational  See: obsolescence, economic.

offer  The action of one person (the offeror) in proposing a contract to another (the offeree); if the offeree accepts the offer, a binding contract is formed.

offeree  One to whom a contract offer is made.

offeror  One who makes a contract offer.

open listing  A nonexclusive listing, given by sellers to as many brokers as they choose. If the property is sold, a broker is only entitled to a commission if the broker was the procuring cause of the sale.
operation of law  A change in conditions based on a change in law. A contract could be made void by a change of law making the purpose illegal.

option  A contract giving one party the right to do something, without obligating the party to do it.

optionee  The person to whom an option is given.

optionor  The person who gives an option.

option to purchase  An option giving the optionee the right to buy property owned by the optionor at an agreed price during a specified period.

ordinance  A law passed by a local legislative body, such as a city council.

orientation  The placement of a house on its lot, with regard to its exposure to the sun and wind, privacy from the street, and protection from outside noise.

origination fee  A fee a lender charges a borrower upon making a new loan, intended to cover the administrative costs of making the loan.

overimprovement  An improvement that is more expensive than justified by the value of the land.

owner's policy  A policy of title insurance that protects the owner of property from financial loss because of unidentified defects in the title. In the case of the sale of property, this is also called a buyer's policy.

ownership  Title to property, dominion over property; the rights of possession and control.

ownership, concurrent  Shared ownership of one piece of property by two or more individuals, each owning an undivided interest in the property (as in a tenancy in common or joint tenancy). Also called multiple ownership, co-ownership, or co-tenancy.

ownership in severalty  Ownership by one individual or entity; sole ownership.

package mortgage  A mortgage used in home financing that is secured by certain items of personal property (such as appliances or carpeting) in addition to the real property.

panic selling  See: blockbusting.

parallels  Imaginary lines running east and west, parallel to the equator. Also called latitude lines.

parcel  A lot or piece of real estate, especially a specified part of a larger tract.

partial performance  When one party to a contract has not completely accomplished all the terms of the agreement, but the other party agrees to accept the incomplete performance and consider the contract discharged.

partial release clause  1. A clause in a blanket mortgage that allows the borrower to get part of the security property released from the lien when a certain portion of the debt has been paid or other conditions are fulfilled. Often called a partial release clause. 2. A clause in a contract for deed providing for a deed to a portion of the land to be delivered when a certain portion of the contract price has been paid. Also known as a deed release provision.

partial satisfaction  The instrument given to the borrower when part of the security property is released from a blanket mortgage under a partial release clause.

partially amortized loan  A loan with equal consecutive payments of principal and interest calculated so that at the end of the term there is still a balance larger than the last regular payment. The balance is called a balloon payment.

partition  The division of a property among its co-owners, so that each owns part of it in severalty; this may occur by agreement of all the co-owners (voluntary partition), or by court order (judicial partition).

partner, general  A partner who has the authority to manage and contract for a general or limited partnership, and who is personally liable for the partnership’s debts.

partner, limited  A partner in a limited partnership who is primarily an investor and does not participate in the management of the business, and who is not personally liable for the partnership’s debts.

partnership  An association of two or more persons to carry on a business for profit. The law generally regards a partnership as a group of individuals, not as an entity separate from its owners. Compare: corporation.

partnership, general  A partnership in which each member has a right to manage the business and share in the profits, as well as responsibility for the partnership’s debts. All of the partners are general partners.

partnership, limited  A partnership made up of one or more general partners and one or more limited partners.

party wall  A wall located on the boundary line between two adjoining parcels of land that is used or intended to be used by the owners of both properties.

patent  The instrument used to convey government land to a private individual.

payee  In a promissory note, the party who is entitled to be paid; the creditor or lender. Compare: maker.

per annum  Per year; usually refers to an annual rate of expense.

per diem  Per day; usually refers to the daily rate of an expense, or to a daily stipend paid.

percentage lease  A lease in which the rent is based on a percentage of the tenant’s monthly or annual gross sales.

periodic tenancy  See: estate from period to period.
personal property  Any property that is not real property; movable property not affixed to land. Also called chattels or personalty.

personalty  Personal property.

physical deterioration  Loss in value (depreciation) resulting from wear and tear or deferred maintenance.

physical life  An estimate of the time a building will remain structurally sound and capable of being used. Compare: economic life.

plaintiff  The party who brings or starts a civil lawsuit; the one who sues.

planned unit development (PUD)  A development (usually residential) with small, clustered lots designed to leave more open space than traditional subdivisions.

planning commission  A local government agency responsible for preparing the community's master development plan.

plat  A detailed survey map of a subdivision, recorded in the county where the land is located. Subdivided property is often called platted property.

plot plan  A plan showing lot dimensions and the layout of improvements (such as buildings and landscaping) on a property site.

plottage  The increment of value that results when two or more lots are combined to produce greater value. Also called the plottage increment.

PMI  See: insurance, private mortgage.

point  One percent of the principal amount of a loan. See also: discount points.

point of beginning (POB)  The starting point in a metes-and-bounds description; a monument or a point described by reference to a monument.

points  See: discount points.

police power  The constitutional power of the state government (delegated to local governments) to enact and enforce laws for the protection of the public's health, safety, morals, and general welfare. Many land use laws such as zoning and environmental limitations are part of police power.

possession  1. The holding and enjoyment of property. 2. Actual physical occupation of real property.

possessory interest  An interest in property that includes the right to possess and occupy the property. The term includes all estates (leasehold as well as freehold), but does not include encumbrances.

power of attorney  A document authorizing one person (the attorney in fact) to act as another's agent, to the extent stated in the instrument.

prepayment  Paying off part or all of a loan before payment is due.

prepayment penalty  A penalty charged to a borrower who prepays.

prepayment privilege  A borrower's right to pay off a loan before it is due, in the absence of a prepayment penalty provision.

prescription  Acquiring an interest in real property (usually an easement) by using it openly and without the owner's permission for the period prescribed by statute.

prescriptive easement  The easement gained by prescription.

primary (employing) broker  The managing broker of a brokerage firm responsible to supervise all other employed licensees.

primary mortgage market  The market in which mortgage loans are originated, where lenders make loans to borrowers. Also called the local market. Compare: secondary mortgage market.

prime rate  The interest rate a bank charges its largest and most desirable customers.

principal  1. One who grants another person (an agent) authority to represent him or her in dealings with third parties. 2. One of the parties to a transaction (such as a buyer or seller), as opposed to those who are involved as agents or employees (such as a broker or escrow agent). 3. In regard to a loan, the amount originally borrowed, as opposed to the interest.

principal meridian  In the rectangular survey system, the main north-south line in a particular grid, used as the starting point in numbering the ranges.

principal residence  Real property that is the owner's home, his or her main dwelling. Under the federal income tax laws, a person can only have one principal residence at a time.

principle of conformity  An appraisal principle which holds that the maximum value of property is realized when there is a reasonable degree of social and economic homogeneity (similarity) in the neighborhood. Property values are maintained in neighborhoods where the properties are all similar. See also: progression and regression.

principle of contribution  An appraisal principle holding that the value of real property is greatest when the improvements produce the highest return commensurate with their cost (the investment). Also called the principle of increasing and decreasing returns.
principle of substitution  A principle of appraisal holding that the maximum value of a property is set by how much it would cost to obtain another property that is equally desirable, assuming that there would not be a long delay or significant incidental expenses involved in obtaining the substitute.

prior appropriation  A system of allocating water rights, under which a person who wants to use water from a certain lake or river is required to apply for a permit; a permit has priority over other permits that are issued later. Compare: riparian rights.

private restrictions  Restrictions on the use of land that are contained in deeds or contracts; as opposed to public restrictions, which are imposed by zoning laws and other government regulations.

probate  A judicial proceeding in which the validity of a will is established and the executor is authorized to distribute the estate property; or, when there is no valid will, in which an administrator is appointed to distribute the estate to the heirs.

probate court  A court that oversees the distribution of property under a will or intestate succession.

procuring cause  The real estate agent who is primarily responsible for bringing about a sale—for example, by negotiating the agreement between the buyer and seller. The agent who produces a buyer ready, willing, and able to buy the property on the seller’s terms.

progression  Part of the principle of conformity holding that a property of lesser value tends to be worth more when it is located in an area with properties of greater value than it would be if located elsewhere. A smaller house surrounded by large houses will be more valuable than the same house surrounded by similar-sized houses. The opposite is the regression. See also: conformity

promissory note  See: note, promissory

property  1. The rights of ownership in a thing, such as the right to use, possess, transfer, or encumber it. 2. Something that is owned.

property manager  A person hired by a property owner to administer, market, and maintain property, especially rental property.

property tax  See: tax, property

proprietary lease  In a cooperative, the right of a shareholder/resident to occupy a particular unit.

proration  The process of dividing or allocating something (especially a sum of money or an expense) proportionately, according to time, interest, or benefit.

public record  The official collection of legal documents that individuals have filed with the county recorder in order to make the information contained in them public.

puffing  Superlative statements about the quality of a property that should not be considered assertions of fact.

purchase agreement  A contract in which a seller promises to convey title to real property to a buyer in exchange for the purchase price. Also called a purchase and sale agreement, deposit receipt, earnest money agreement, sales contract, or contract of sale.

purchase money mortgage  1. When a seller extends credit to a buyer to finance the purchase of the property, accepting a mortgage instead of cash. Sometimes called a carryback loan. 2. In a more general sense, any loan the borrower uses to buy the security property (as opposed to a loan secured by property the borrower already owns).

qualified acceptance  See: counteroffer

qualified fee  A fee estate subject to a limitation or condition. Also called a defeasible fee. Ownership could be lost by violating the condition.

qualifying standards  The standards a lender requires a loan applicant to meet before a loan will be approved. Also called underwriting standards.

quiet enjoyment  Use and possession of real property without interference from the previous owner, the lessor, or anyone else claiming title. See also: covenant of quiet enjoyment.

quiet title action  A lawsuit to determine who has title to a piece of property, or to remove a cloud from the title.

quitclaim deed  A deed that conveys any interest in a property that the grantor has at the time the deed is executed, without warranties. Also called a problem solver. Compare: deed, correction.

range  In the rectangular survey system, a strip of land six miles wide, running north and south.

range lines  In the rectangular survey system, the north-south lines (meridians) located six miles apart.

ratify  To confirm or approve after the fact an act that was not authorized when it was performed.

real estate  Land and everything attached to or appurtenant to it, including the improvements on the land and the rights that go with ownership of the land. Also called realty or real property. Compare: personal property.

real estate contract  1. A purchase agreement. 2. A contract for deed. 3. Any contract having to do with real property.
real property  Land and everything attached to or appurtenant to it, including the improvements on the land and the rights that go with ownership of the land. Also called realty or real estate. Compare: personal property.

REALTOR®  A real estate agent who is an active member of a state and local real estate board that is affiliated with the National Association of REALTORS®.

realty  See: real property.

recapture  Recovery by the investor of money invested in real estate.

receiver  A person appointed by a court to manage and look after property or funds involved in litigation or foreclosure.

reconciliation  The final step in an appraisal, when the appraiser assembles and interprets the data in order to arrive at a final value estimate. Never an average. Also called correlation.

reconveyance  In states where deeds of trust are used, releasing the security property from the lien created by a deed of trust by recording a deed of reconveyance (the equivalent of a satisfaction of mortgage).

recording  Filing a document at the county recorder’s office, so that it will be placed in the public record and give constructive notice.

rectangular survey system  A system of grids made up of range and township lines that divide the land into townships, which are further subdivided into sections; a particular property is identified by its location within a particular section, township, and range. Also called the government survey system or the section, township, and range system.

redemption  1. Payment of all delinquent amounts, plus costs, by a defaulting mortgagor, thereby reinstating the loan and preventing foreclosure. 2. Payment of whatever the foreclosure sale purchaser paid for the property, plus interest and expenses, which allows a mortgagor to keep the property after the foreclosure sale.

redemption, equitable right of  The right of a mortgagor to cure the default and reinstate the loan before the foreclosure sale.

redemption, statutory right of  See: statutory right of redemption.

redlining  Refusal by a lender to make loans secured by property in a certain neighborhood because of the racial or ethnic composition of the neighborhood, in violation of fair lending laws.

regression  Part of the conformity principle holding that a property of noticeably lower quality than those around it will tend to decrease the value of those neighboring properties; the opposite of progression. A well-maintained house next to a poorly maintained house will be less valuable than the same house surrounded by well-maintained houses. See also: conformity.

Regulation Z  The Federal Reserve Board’s regulation that implements the Truth in Lending Act. See also: Truth in Lending Act.

reinstate  To prevent foreclosure by curing the default.

release  1. To give up a legal right. 2. A document in which a legal right is given up.

release clause  See: partial release clause.

remainder  A future interest that becomes possessory when a life estate terminates, and that is held by someone other than the grantor of the life estate; as opposed to a reversion, which is a future interest held by the grantor (or his or her successors in interest). Often called an estate in remainder.

remainderman  The person who has an estate in remainder.

remaining economic life  See: economic life.

rent  Compensation paid by a tenant to the landlord in exchange for the possession and use of the property.

rent, contract  The rent that is actually being paid on property that is currently leased.

replacement cost  In appraisal, the current cost of constructing a building with the same utility as the subject property with modern materials and construction methods.

replevin  Legal proceedings undertaken by a tenant to recover possession of personal belongings that have been unlawfully confiscated by a landlord (usually for nonpayment of rent).

reproduction cost  In appraisal, the cost of constructing a replica (an exact duplicate) of the subject property, using the same materials and construction methods that were originally used, but at current prices.

rescission  Termination of a contract when each party gives anything acquired under the contract back to the other party. (The verb form is rescind.) Compare: cancellation.

reservation  A right retained by a grantor when conveying property; for example, mineral rights, an easement, or a life estate can be reserved in the deed.

reserves for replacement  For income-producing property, regular allowances set aside to pay for the replacement of structures and equipment that are expected to wear out.
resident manager  A salaried manager of a single apartment building or complex who resides on the property; unlike a property manager, a resident manager is not required to have a real estate license.

residual  1. A property's remaining value after the economic life of the improvements has been exhausted.


restitution  Restoring something to a person that he was unjustly deprived of.

restriction  A limitation on the use of real property.

restriction, deed  See: deed restriction.

restriction, private  See: private restriction.

restriction, public  A law or government regulation limiting or regulating the use of real property.

restrictive covenant  See: covenant, restrictive.

reverse annuity mortgage  A type of mortgage loan in which a homeowner borrows against the equity in the property in monthly installments. The lender provides monthly payments from the equity. (The mortgagor pays the mortgagor.) The loan is paid off when the owner sells the property or dies.

reversion  A return of property rights at a future time. A landlord regains the right of possession at the termination of a lease through reversion. A future interest that becomes possessory when a temporary estate (such as a life estate) terminates, and that is held by the grantor (or her successors in interest). Often called an estate in reversion. Compare: remainder.

reverter  The person who holds a life estate in reversion.

revocation  Canceling an agreement or a license. A principal can revoke an agent's authority and a licensing authority can revoke a real estate licensee's license.

rezone  See: zoning amendment.

right of survivorship  The right of a surviving owner in a joint tenancy ownership. Surviving owners automatically gain ownership of the deceased owner's share.

right of way  An easement that gives the holder the right to cross another person's land.

riparian land  Land that is adjacent to or crossed by a body of water, especially flowing water such as a stream or a river. Compare: littoral land.

riparian rights  The water rights of a landowner whose property is adjacent to or crossed by a body of water. Compare: appropriation, prior.

running with the land  Binding or benefiting the successive owners of a piece of property, rather than terminating when a particular owner transfers his interest. Usually said in reference to an easement or a restrictive covenant.

S

sale-leaseback  A form of real estate financing in which the owner of industrial or commercial property sells the property and leases it back from the buyer; in addition to certain tax advantages, the seller/lessee obtains more cash through the sale than would normally be possible by borrowing and mortgaging the property because lenders will not often lend 100 percent of the property's value.

salesperson  In real estate, a licensee who works for a broker and does not have the authority to supervise others.

sales comparison approach  See: market data approach.

sandwich lease  A leasehold interest lying between the property owner's interest and the interest of the tenant in possession; for example, when a tenant subleases the property to a subtenant, the original tenant's interest is sandwiched between the interest of the landlord and that of the subtenant.

satisfaction of mortgage  The document a mortgagor gives the mortgagor when the mortgage debt has been paid in full, acknowledging that the debt has been paid and the mortgage is no longer a lien against the property; should always be recorded.

savings and loan association  A type of financial institution that has traditionally specialized in home mortgage loans.

savings bank  A type of financial institution that has traditionally emphasized consumer loans and accounts for small depositors.

scarcity  A limited or inadequate supply of something; this is one of the four elements of value (along with utility, demand, and transferability).

secondary financing  Money borrowed to pay part of the required down payment or closing costs for a first loan, when the second loan is secured by the same property that secures the first loan.

secondary mortgage market  The market in which investors (including Fannie Mae [FNMA], Freddie Mac, and Ginnie Mae) purchase and sell real estate loans from primary lenders; also called the national market.

section  In the rectangular survey system, a section is one mile square and contains 640 acres. There are 36 sections in a township.

security agreement  Under the Uniform Commercial Code, a document that creates a lien on personal property being used to secure a loan. Typically used in conjunction with a financing statement.
security deposit  Money a tenant gives a landlord at the beginning of the tenancy to protect the landlord in case the tenant fails to comply with the terms of the lease; the landlord may retain all or part of the deposit to cover unpaid rent or repair costs at the end of the tenancy.

security instrument  A document that creates a voluntary lien to secure repayment of a loan; for debts secured by real property, it is either a mortgage or a deed of trust.

security interest  The interest a creditor may acquire in the debtor's property to ensure that the debt will be paid; the interest created by a security agreement or a mortgage.

security property  The property that a borrower gives a lender a voluntary lien against, so that the lender can foreclose if the borrower defaults on the loan.

seisin  Actual possession of a freehold estate; ownership. Sometimes spelled seizin or seizen.

seller financing  Typically either a purchase money mortgage or contract for deed. 1. Purchase money mortgage: When a seller extends credit to a buyer to finance the purchase of the property, accepting a mortgage instead of cash. Sometimes called a carryback loan. 2. Contract for deed: A contract for the sale of real property in which the buyer (the vendee) pays in installments; the buyer takes possession of the property immediately, but the seller (the vendor) retains legal title until the full price has been paid. Also called an installment land contract, or land contract.

separate property  In a community property state, property owned by a married person that is not community property; includes property acquired before marriage or by gift or inheritance after marriage.

setback requirements  Provisions in a zoning ordinance that do not allow structures to be built within a certain distance of the property line.

settlement  1. Closing. 2. An agreement between the parties to a civil lawsuit in which the plaintiff agrees to drop the suit in exchange for money or the defendant's promise to do or refrain from doing something.

settlement statement  A document that presents a final, detailed accounting for a real estate transaction, listing each party's debits and credits and the amount each will receive or be required to pay at closing. Also called a closing statement.

Settlement Statement (HUD-1)  A settlement statement required for any transaction involving a loan that is subject to the Real Estate Settlement Procedures Act (RESPA).

severance  1. Termination of a joint tenancy. 2. The permanent removal of a natural attachment, fixture, or appurtenance from real property, which transforms the item into personal property.

severance, constructive  When a landowner enters into a contract to sell an appurtenance or natural attachment, the contract constructively severs the item from the land—making it the personal property of the buyer—even before the buyer has actually removed it from the land. For example, when a landowner sells a stand of timber, the trees are constructively severed from the land even before the buyer comes to chop them down.

shareholder  See: stockholder.

sheriff's sale  A mortgage foreclosure sale. Sometimes called an execution sale.

sheriff's deed  The deed used to convey a property after the redemption rights have expired in a foreclosure through the courts.

special agent  An agent with limited authority to do a specific thing or conduct a specific transaction. Has no power to bind the principal.

special assessment  A tax levied only against the properties that have benefited from a public improvement (such as a sewer or a street light), to cover the cost of the improvement; creates a special assessment lien.

special (limited) warranty deed  A conveyance deed with the warranties limited to the ownership period of the grantor.

specific lien  A lien against a particular named parcel of property. The lien may be foreclosed by having the collateral property sold and the proceeds applied to the loan balance.

specific performance  A legal remedy in which a court orders someone who has breached a contract to actually perform the contract as agreed, rather than simply paying money damages to the other party.

spot zoning  A rezone of one property or a small area within a neighborhood.

SRA  A member of the Society of Real Estate Appraisers.

SREA  The Society of Real Estate Appraisers.

statute  A law enacted by a state legislature or the U.S. Congress.

statute of frauds  A state law that requires certain types of contracts to be in writing and signed in order to be enforceable.

statute of limitations  A law requiring a particular type of lawsuit to be filed within a specified time after the event giving rise to the suit occurred.
statutory lien  A lien created by statute, such as a government lien for property taxes.

statutory redemption  The right of mortgagors to keep their property after a foreclosure sale by paying the amount that the highest bidder at the sale paid, plus interest and expenses. Also called post-sale redemption.

steering  Channeling prospective buyers or tenants to or away from particular neighborhoods based on their race, religion, national origin, or ancestry, in violation of anti-discrimination laws.

step-up lease  A type of graduated lease in which the rent increases are part of the lease document.

stockholder  An individual who holds an ownership share in a corporation (and has limited liability). Also called a shareholder.

straight loan  A loan in which no principal is paid during the loan and the entire amount is due at the end of the term. Interest may be paid periodically or at the end depending on the agreement. Also called term loan.

subagent  A person to whom an agent has delegated authority, so that the subagent can assist in carrying out the principal’s orders; the agent of an agent.

subcontractor  A contractor who, at the request of the general contractor, provides a specific service, such as plumbing or drywalling, in connection with the overall construction project.

subdivision  1. A piece of land divided into two or more parcels. 2. A residential development.

subdivision plat  See: plat.

subdivision regulations  State and local laws that must be complied with before land can be subdivided.

subject to  When purchasers take property subject to a mortgage, they are not personally liable for paying off the loan; in case of default, however, the property can still be foreclosed on.

sublease  An arrangement in which a tenant grants someone else the right to possession of the leased property for part of the remainder of the lease term; as opposed to an assignment, in which the tenant gives up possession for the entire remainder of the lease term.

subordination clause  A provision in a mortgage that permits a later mortgage to have higher lien priority than the one containing the clause.

subrogation  The substitution of one person in the place of another with reference to a lawful claim or right. For instance, a title company that pays a claim on behalf of its insured, the property owner, is subrogated to any claim the owner successfully undertakes against the former owner.

substitution, principle of  See: principle of substitution.

substitution of liability  A buyer wishing to assume an existing loan may apply for the lender’s approval; once approved, the buyer assumes liability for repayment of the loan, and the original borrower (the seller) is released from liability.

succession  Acquiring property by will or inheritance.

supply and demand, principle of  A principle holding that value (price) varies directly with demand and inversely with supply; that is, the greater the demand the greater the value (price), and the greater the supply the lower the value.

surrender  Giving up an estate (such as a life estate or leasehold) before it has expired.

survey  The process of precisely measuring the boundaries and determining the area of a parcel of land. Used to produce a plat map and to identify encroachments.

survivorship, right of  See: right of survivorship.

syndicate  An association formed to operate an investment business. A syndicate is not a recognized legal entity; it can be organized as a corporation, partnership, limited liability company, or trust.

T

tacking  Adding together successive periods of use or possession by more than one person to make up the statutory period required for adverse possession or prescription.

taking  When the government acquires private property for public use by condemnation, it’s called “a taking.” The term is also used in inverse condemnation lawsuits, when a government action has made private property virtually useless.

tax, ad valorem  A tax assessed on the value of property.

tax, excise  A tax on the production, sale, or consumption of certain commodities. The state deed tax is an example of an excise tax.

tax, general real estate  An annual ad valorem tax levied on real property. Often called property taxes.

tax, improvement  See: special assessment.

tax, property  1. The general real estate tax. 2. Any ad valorem tax levied on real or personal property.

tax credit  A credit that is subtracted directly from the amount of tax owed. Compare: deduction.

tax-free exchange  A transaction in which one piece of property is traded for a piece of like-kind property. If the property involved is held for investment or the production of income, or used in a trade or business, tax on the gain may be deferred.

tax sale  Sale of property after foreclosure of a tax lien.

tenancy  Lawful possession of real property; an estate.
tenancy, joint  See: joint tenancy.
tenancy, month-to-month  See: estate from period to period.
tenancy, periodic  See: estate from period to period.
tenancy, term  See: estate for years.
tenancy at sufferance  See: estate at sufferance.
tenancy at will  See: estate at will.
tenancy by the entirety  A special form of joint ownership of property by husband and wife used in some states.
tenancy for years  See: estate for years.
tenancy in common  A form of concurrent ownership in which two or more persons each have an undivided interest in the entire property, but no right of survivorship. Compare: tenancy, joint.
tenant  Someone in lawful possession of real property; especially, someone who has leased property from the owner.
tenant, dominant  A person who has easement rights on another's property; either the owner of a dominant tenement, or someone who has an easement in gross.
tenant, holdover  A lessee who remains in possession of the property after the lease term has expired.
tenant, life  Someone who owns a life estate; not necessarily used as the measuring life for the life estate.
tenant, servient  The owner of a servient tenement—that is, someone whose property is burdened by an easement.
tenement, dominant  Property that receives the benefit of an easement appurtenant.
tenement, servient  Property burdened by an easement. In other words, the owner of the servient tenement (the servient tenant) must allow someone who has an easement (the dominant tenant) to use the property.
tenements  Everything of a permanent nature associated with a piece of land that is ordinarily transferred with the land. Tenements are both tangible (e.g., buildings) and intangible (e.g., air rights).
tenure  The period of time during which a person holds certain rights with respect to a piece of real property.
term  A prescribed period of time; especially, the length of time a borrower has to pay off a loan, or the duration of a lease.
term loan  See: straight loan.
testate  Refers to someone who has died and left a will. Compare: intestate.
testator  A person who makes a will. (If it is a woman, she may be referred to as a testatrix.)
third party  1. A person seeking to deal with a principal through an agent. 2. In a transaction, someone who is not one of the principals.
tight money market  A situation in which loan funds are scarce, resulting in high interest rates and discount points.
TILA  Truth in Lending Act.
time is of the essence  A clause in a contract that means performance on the exact dates specified is an essential element of the contract; failure to perform on time is a material breach.
time-share  An ownership arrangement in which co-owners each have an exclusive right to use a condominium unit (or other property) for a specified time period each year.
title  Lawful ownership of real property. Also, the deed or other document that is evidence of that ownership.
title, abstract of  See: abstract of title.
title, clear  See: clear title.
title, color of  Title that appears to be good title, but which in fact is not; commonly based on a defective instrument, such as an invalid deed.
title, equitable  The vendee's interest in property under a real estate contract. Also called an equitable interest. Compare: title, legal.
title, imperfect  Defective or incomplete title. Adverse possessors have imperfect title until they obtain a quitclaim deed from the owner of the land adversely possessed, or they prevail in a quiet title action confirming that the requirements for acquiring title by continuous use have been met.
title, legal  The vendor's interest in property under a real estate contract. Compare: title, equitable.
title, marketable  See: marketable title.
title commitment  A binding agreement by a title insurance company to insure the marketability of title under stated conditions and with listed exclusions and exceptions.
title company  A title insurance company.
title insurance  Insurance that protects against losses resulting from undiscovered title defects. An owner's policy protects the buyer, while a mortgagee's policy protects the lien position of the buyer's lender.
title opinion  An attorney's letter of opinion on the condition of title based on evaluation of an abstract. The attorney will normally state the present owner of record and the current encumbrances and other title limitations found in the public record.
title plant  A duplicate (usually microfilmed) of a county's public record, maintained by a title company at its offices for use in title searches.
title report  A report issued by a title company, disclosing the condition of the title to a specific piece of property, before the actual title insurance policy is issued. Often called a preliminary title report. The title report may be part of a title commitment.

title search  An investigation of the public record to determine all rights and encumbrances affecting title to a piece of property.

title theory  The theory holding that a mortgage gives the lender legal title to the security property while the debt is being repaid. Most states follow lien theory instead. Compare: lien theory.

topography  The contours of the surface of the land (level, hilly, steep, etc.).

torrens system  A system of land registration used in some states, which allows title to be verified without a standard title search; title to registered land is free of all encumbrances or claims not registered with the title registrar.

tort  A breach of a duty imposed by law (as opposed to a duty voluntarily taken on in a contract) that causes harm to another person, giving the injured person the right to sue the one who breached the duty. Also called a civil wrong (in contrast to a criminal wrong, a crime).

total finance charge  Under the Truth in Lending Act, the total finance charge on a loan includes interest, any discount points paid by the borrower, the loan origination fee, and mortgage insurance costs.

town house  Combines ownership in fee simple with tenancy in common (an undivided interest in the common elements). In a townhouse development, each owner not only owns a dwelling unit, but also owns the lot.

township  In the rectangular survey system, a parcel of land six miles square, containing 36 sections; the intersection of a range and a township tier.

township lines  Lines running east-west, spaced six miles apart, in the rectangular survey system.

township tier  In the rectangular survey system, a strip of land running east-west, six miles wide and bounded on the north and south by township lines.

trade fixtures  Articles of personal property attached to real property by a tenant for use in a trade or business, which the tenant is allowed to remove at the end of the lease.

transferability  If an item is transferable, then ownership and possession of that item can be conveyed from one person to another. In appraisal, transferability is one of the four elements of value, along with utility, scarcity, and demand.

trespass  An unlawful physical invasion of property owned by another.

trust  A legal arrangement in which title to property (or funds) is vested in one or more trustees, who manage the property on behalf of the trust’s beneficiaries, in accordance with instructions set forth in the document establishing the trust.

trust account  A bank account, separate from a real estate broker's personal and business accounts, used to segregate trust funds from the broker's own funds.

trust deed  See: deed of trust.

trustee  1. A person appointed to manage a trust on behalf of the beneficiaries. 2. A neutral third party appointed in a deed of trust to handle the nonjudicial foreclosure process in case of default.

trustee in bankruptcy  An individual appointed by the court to handle the assets of a person in bankruptcy.

trustee's sale  A nonjudicial foreclosure sale under a deed of trust.

trust funds  Money or things of value received by an agent, not belonging to the agent but being held for the benefit of others. Example: earnest money held for a purchase agreement.

trustor  The borrower on a deed of trust. Also called the grantor.

Truth in Lending Act (TILA)  The act implemented by Regulation Z requiring disclosure of the true cost of borrowing for consumer credit transactions.

underimprovement  An improvement which, because of deficiency in cost or size, is not the most profitable use of the land; not the highest and best use.

underwriting  In real estate lending, the process of evaluating a loan application to determine the probability that the applicant would repay the loan, and matching the risk to an appropriate rate of return. Sometimes called risk analysis.

undivided interest  A co-owner's interest, giving him or her the right to possession of the whole property, rather than to a particular section of it.

undue influence  Exerting excessive pressure on someone so as to overpower the person's free will and prevent him or her from making a rational or prudent decision; often involves abusing a relationship of trust. Undue influence can make a contract voidable.

unenforceable  An agreement or supposed agreement that the courts will not hold the parties responsible to perform.
Uniform Commercial Code A body of law adopted in slightly varying versions in most states, which attempts to standardize commercial law dealing with such matters as negotiable instruments and sales of personal property. Its main applications to real estate law concern security interests in fixtures and bulk transfers.

unilateral contract A contract that is accepted by performance; the offeror has promised to perform his or her side of the bargain if the other party performs, but the other party has not promised to do so. Compare: contract, bilateral.

unit owners association In a condominium or other common interest community, an organization that all unit owners automatically belong to, which governs the common elements of the condominium. Often called a condominium association.

universal agent An agent authorized to do everything that can be lawfully delegated to a representative. Generally created by a power of attorney or court order. Has unlimited power to bind the principal.

unjust enrichment An undeserved benefit; a court generally will not allow a remedy (such as forfeiture of a contract for deed) if it would result in the unjust enrichment of one of the parties.

unlawful detainer A summary legal action to regain possession of real property; especially, a suit filed by a landlord to evict a defaulting tenant.

useful life See: economic life.

usury Charging an interest rate that exceeds legal limits.

utility The ability of an item to satisfy some need and/or arouse a desire for possession. In appraisal, one of the four elements of value, with scarcity, demand, and transferability.

VA U.S. Department of Veterans Affairs.

VA-guaranteed loan A home loan made by an institutional lender to an eligible veteran, where the Department of Veterans Affairs will reimburse the lender for losses if the veteran borrower defaults.

vacancy factor See: bad debt/vacancy factor.

valid The legal classification of a contract that is binding and enforceable in a court of law.

valuable consideration See: consideration.

valuation See: appraisal.

value Generally, how much something is worth; the present worth of future benefits. In real estate, the term is most often used to refer to market value.

value, assessed The value placed on property by the taxing authority (the county assessor, for example) for the purposes of taxation.

value, face The value of an instrument, such as a bond, that is indicated on the face of the instrument itself.

value, market See: market value.

value, salvage The estimated amount for which a structure can be sold at the end of its useful life.

value, subjective The value of a product in the eyes of a particular person.

value, utility The value of a property to its owner or to a user. Also called value in use.

value in exchange See: market value.

variable interest rate A loan interest rate that can be adjusted periodically during the loan term, as in the case of an adjustable-rate mortgage.

variance Permission (obtained from the local zoning authority) to build a structure in a way that violates the strict terms of the zoning ordinance. Usually a minor deviation.

vendee A buyer or purchaser; particularly, someone buying property under a contract for deed.

vendor A seller; particularly, someone selling property by means of a contract for deed.

vested right An immediate fixed right, interest, or title in real property, even though the right to possession of the property may not occur until sometime in the future.

void Having no legal force or effect.

voidable contract A contract that one of the parties can disaffirm without liability because of lack of capacity or a negative factor affecting consent, such as fraud or duress.

waiver The voluntary relinquishment or surrender of a right.

warranty, implied In a sale or lease of property, a guarantee created by operation of law, whether or not the seller or landlord intended to offer it.

warranty, forever In a deed, a promise that the grantor will bear the expense of defending the grantee’s title if anyone asserts a rightful claim against it. See also: general warranty deed.

warranty of habitability See: habitability, implied warranty of.

waste Destruction, damage, or material alteration of property by someone in possession who holds less than a fee estate (such as a life tenant or a lessee), or by a co-owner.
water rights  The right to use water from a body of water. See also: appropriation, prior; littoral rights; riparian rights.

water table  The level at which water may be found, either at the surface or underground.

will  A person’s stipulation regarding how her estate should be disposed of after she dies. Also called a testament.

will, formal  A will that meets the statutory requirements for validity; as a general rule, it must be in writing and signed in the presence of at least two competent witnesses.

will, holographic  A will written entirely in the testator’s handwriting, which may be valid in some states even if it was not witnessed.

without recourse  A qualified or conditional endorsement on a negotiable instrument, which relieves the endorser of liability under the instrument.

words of conveyance  The essential portion of a deed stating an intention to convey the property to the grantee. Also called a granting clause.

writ of execution  A court order directing a public officer (such as the sheriff) to seize and sell property to satisfy a debt.

writ of possession  A court order issued after an unlawful detainer action, informing the tenant to vacate the landlord’s property within a specified period or be forcibly removed by the sheriff.

Y

yield  The return of profit to an investor on an investment, stated as a percentage of the amount invested.

Z

zone  An area of land set off for a particular use or uses, subject to certain restrictions.

zoning  Government regulation of the uses of property within specified areas.

zoning amendment  An amendment to a zoning ordinance, usually changing the uses allowed in a particular zone. Also called a rezone.