

REAL ESTATE *principles*



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LUMBLEAU REAL ESTATE SCHOOL

LUMBLEAU REAL ESTATE SCHOOL
Real Estate Principles – First Edition, 2020
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Lumbleau Real Estate School was founded in 1938, making it one of the oldest and best recognized names in approved real estate schools in California real estate education. Over 600,000 students have passed through our courses. The Lumbleau Real Estate School now delivers online real estate classes to students in the comfort and convenience of their homes. Lumbleau Real Estate School is staffed with a team of dedicated real estate professionals who are available to answer students' questions and provide valuable insight into the real estate industry.



acknowledgments

WE WISH TO THANK OUR STUDENTS AND BROKER PARTNERS
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real estate education textbooks available. Input from Community
College instructors, brokers and agents is invaluable.

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WE WISH TO THANK OUR GRAPHIC DESIGNERS
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preface

In 1938, Walter J. Lumbleau believed that there is no reason why a real estate broker should not be an intelligent broker. It will not cost him/her anything of material value to be well informed, and it may cost him/her a fortune to work in ignorance. Walt published *The Real Estater* and *The Real Estate Educator* in the 1940's. His son, John J. Lumbleau, became president of the Lumbleau Real Estate School of California in 1952, publishing *The Creation of a Successful Real Estate Salesman* in 1966.

In 2000, Lumbleau Real Estate School went online to make real estate education more affordable and convenient. Students can now learn at their own pace in the comfort of their home. New management, websites, updates and input from some of California's most experienced brokers has enhanced our educational material and made it available to even more students. Over 800,000 students have experienced the Lumbleau training method.

Our staff is comprised of licensed agents, brokers and real estate educators to provide our students with the best support possible.

WALT AND JOHN WOULD BE PROUD!



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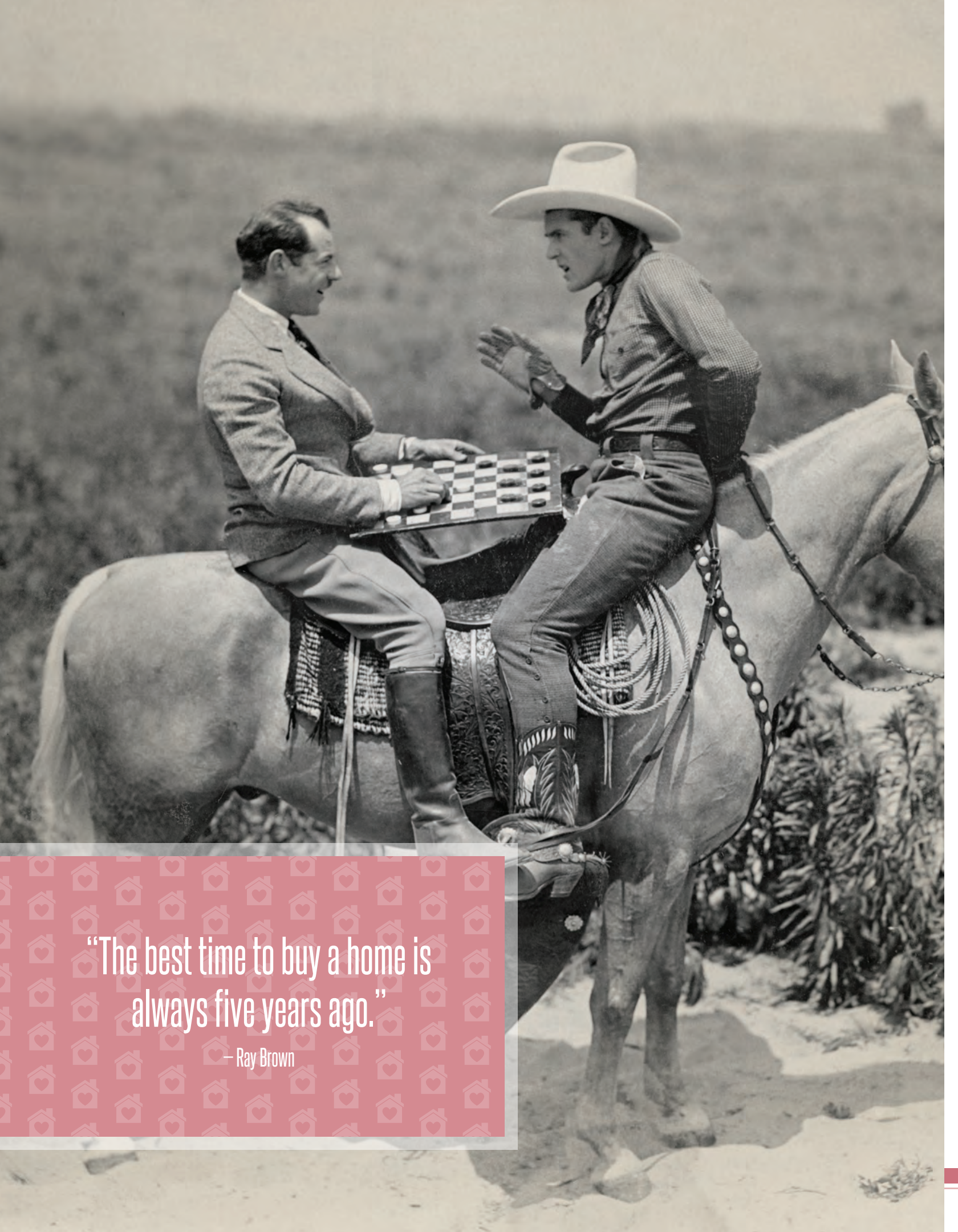
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“The best time to buy a home is
always five years ago.”

— Ray Brown

CHAPTER 1:

regulation & control of real estate licensees

Learning Objectives

Real estate sales activity is regulated by real estate law, the California Department of Real Estate (DRE) and the Commissioner. This chapter details some of the regulations required of brokers and agents in this profession.

We also look at many of the opportunities available to licensees. This includes a variety of fields available including sales and leases of residential, commercial, business opportunities, appraisal and other specialized fields.

key terms

1031 Exchange	Continuing Education (CE)	Mortgage
Advance Fee	Conversion	Neutral Escrow
Appraisal Institute	Deed of Trust	Prepaid Residential Listing License
Bill of Sale	Desk Cost	Real Estate Counselor
Business Opportunity	Land Locator	Trust Deed
Commingling	Listing	WORM
Company Dollar	Manufactured Home	
Consumer Recovery Account	Mobilehome	

Opportunities in Real Estate

Sixty two percent of America's wealth is invested in real estate according to the National Association of Home Builders. About twenty three percent of one's lifetime income is invested in some form of real estate. It's a desirable product, people want it for diverse reasons, and it is a big-ticket item to most.

When your client or customer wants to sell or buy a home, a business, an apartment, raw land, industrial property, shares in real estate syndication, mineral, oil or gas property, or government lands, or when a property owner wants your property management counseling, or appraisal services, the real estate salesperson or broker assuredly will be dealing in the very sensitive area of the client's pocket book.

Therefore, the real estate salesperson entering this field of opportunity must learn the craft and serve people diligently. You, the licensee, will be dealing with people of varying habits, personalities, and wealth, as well as with incidents of ownership and transfer of their property rights. As an independent contractor (you're essentially in your own business), your time is precious and you must manage it for scheduling appointments inspecting properties, updating yourself technically, and above all, learning more about "the psychology of habits" of people. How many times you will hear "the real estate business is a people business!"

For the successful salesperson who will inevitably become a broker, the real estate business is probably the most monetarily rewarding of all businesses, as measured by the time and effort invested. It's personally rewarding, too, when you've served your client well, as will be evidenced by their satisfaction and referrals of others to you.

There are many facets and specialties within the "real estate business" which require a solid knowledge of the fundamentals. We discuss some of these disciplines in the following pages. Each of them spell opportunity for the person suited and trained for it.

Because the real estate housing market is varied in nature and because the housing market deals with many different types of desires and needs, it is said to be stratified. Stratified means different levels. People acquire property for a specific purpose such as residential, business, investment, agricultural, or industrial. Therefore, demands fall within certain definable levels.

Residential Real Estate Sales

Most people entering the real estate profession start by listing and selling residential properties, usually single family dwellings. Homes are the bread and butter merchandise of the business through periods of prosperity, recession, depression, war and peace. Success in listing and selling in the residential market has been the sure path to breaking into the commercial, industrial, and other areas of the business.

Some licensees make a specialty of listing; some make selling their sole activity. However, for professional development, listing and selling will enable you to better serve your clients and customers.

A sound knowledge of contracts, real estate finance, values of homes in your area of operation and enthusiasm are all vital.

A very good knowledge of the multiplicity of financing through FHA, VA, CalVet and conventional methods available in today's market is an absolute MUST.

Income Producing Residential Sales

While single family dwellings are the mainstay of real estate sales, opportunities exist in selling or exchanging income producing residential properties.

In addition to the fundamentals needed for the single family market, a basic knowledge of income tax laws is essential to advise the client of the tax impact of his/her "taxable event" (i.e., the sale or exchange of his/her income property). A basic knowledge of accounting and property management would also help. These enable you to understand some of the subtleties of income, operating and cash flow statements. For the more involved, which will undoubtedly include the high-ticket properties (\$1 million and up), coordination with a tax attorney, accountant, property manager and appraiser is appropriate.

Commercial Property Sales

Another area of specialized activity which is very attractive to many real estate licensees involves commercial real estate ventures. Such licensees specialize in income producing properties (e.g., office buildings, shopping centers, retail stores and even warehouses). In this type of activity, the licensee would be primarily marketing the monetary benefits of the property involved. Among these benefits are the potential income, appreciation in value, mortgage reduction and income tax which the property might be expected to yield to the owner.

The licensee can also undertake leasing and/or the development of such properties for their owners. The management of these property types for their absentee owners might also provide sources of income for the real estate agent.

In this field of activity, a successful person must be competent in the math required to be able to market this kind of real estate. The practitioner also should know the steps necessary to successfully finance such property acquisitions and be current with the very latest income tax laws affecting such transactions. The licensee should have a sense of what makes a good investment, what makes an investment saleable, and what the growth and development possibilities are in the neighborhood where the property is situated.

Commission income from commercial brokerage is likely to be less frequent than in dealing with single family residential properties. However, income ordinarily is in larger amounts than from residential brokerage activity. The time needed to break into the business is longer than in residential sales, but once in the business, agent turnover tends to be quite low.

Industrial Property Sales

Many industrial real estate brokers require a business management background for listing and selling industrial properties.

For the most part, these types of property are in urban areas. Growing suburban areas, where light industry and industrial sites are made available by farsighted land use policies, afford good opportunities to succeed in industrial brokerage. The licensee must be acquainted with the needs and objectives of the community. What types of industry is needed in the community? Heavy? Light? Or a balance of each? The broker or salesperson can even assist chambers of commerce, community developers, and industry in locating a main or a branch plant in the community.

The licensee should know industrial financing and how to package and present the proposal to industrialists. The package would necessarily include information on transportation facilities, utilities, the property tax base, schools, churches, zoning, economic trends (short and long-term) within the community and region.

Where the trend in many areas is industrial malls or industrial parks, a knowledge of financing and presenting a Diversified Industrial Complex becomes important to the industrial licensee.

Training, information and seminars in this highly technical area are offered by the Society of Industrial and Office Realtors (SIOR).

Business Opportunities

The sale of a **business opportunity** is the sale of personal property. In California, a real estate license is required to list and sell businesses such as restaurants, hair salons, liquor stores, laundromats, etc. If, in addition to the business, underlying real property is to be transferred, it is two separate sales and two commissions. A retail merchandising, manufacturing or an accounting background helps but anyone with a knack for searching out the true value of a business, listing it, and passing it on to a buyer who is looking for “good cash flow” has a good chance of success.

A thorough knowledge of business leases, a good knowledge of financial statement analysis (balance sheet, income statement, cash flow statement), the applicable parts of the Uniform Commercial Code (UCC), standard forms used as security and transfer devices, as well as liquor license values and qualifying for and transferring the license all help. In turn, the latter requires familiarity with the Alcoholic Beverage Control Board procedures.

A highly specialized facet of the real estate business, business opportunities is not for everyone but those who find a place there usually stay and with surprising rewards.

Land Sales

Recreation and Farm Lands

Even though many areas seem to be quickly urbanizing and industrializing, there is still a lot of rural, raw land in California. Just take a plane ride or a drive around the state to observe. Land brokers list and promote raw recreational land they deem ripe for development. The lands are usually located on or near mountain greenery areas or desert areas, usually near man-made lakes and other (planned) facilities. These lands are usually subdivided into large parcels and owned by estates, corporations, or developers. Their promotion, financing and sale are in many instances governed by the Subdivided Lands Act (land projects) incorporated into the Real Estate Law.

The land broker must, above all, be a patient optimist with a ready financing package. Vision, promotional and sales ability of a unique order are included in his/her repertoire.

Farm brokerage requires knowledge of modern farming methods (agribusiness), farm equipment, personal property and other farming accouterments that may be transferred with the business and the realty. A knowledge of the crops, their marketing, their types, their seasons, their values, and soil conditions in the area of operations are helpful to the licensee.

Mineral, Oil and Gas Properties

The sale or leasing of M.O.G. properties under California law requires a real estate license. The Department of Real Estate administers the requirements for such licensees. Since January 1, 1994, a M.O.G. broker license is no longer required. Anyone who is a licensed real estate broker or salesperson may engage in M.O.G. transactions. Those who hold M.O.G. licenses may continue to do so, and may renew their licenses, but no new M.O.G. licenses are issued. Instead, the definition of a real estate broker has been expanded to include mineral, oil and gas transactions.



Federal and State Government Lands

From time to time the Department of Interior (Bureau of Land Management) and the State of California (Lands Commission), release government owned lands for sale or lease to the public. Anyone assisting others for compensation in locating, acquiring or leasing such lands needs a real estate license. These people are often referred to as land locators.

Real Estate Exchanges

The so called **1031 (from Internal Revenue Code Section 1031) tax-deferred**, or **tax-free exchange**, is another specialty area for the business and tax oriented agent.

An owner of income producing property (apartments, motels, farms and raw land - if held for investment), at a time ideal for his/her personal or business financial planning situation, might like to trade his/her property for a like property.

The real estate agent may arrange such a trade for the business and tax advantage of both parties. Two commissions are earned because in such a trade each party is considered a seller as well as a buyer. The exchange may be more complicated having more than two parties. It may be a 5, 6 or 10 “legged” exchange. Usually compensation is based on the dollar value of the exchange and, like most commissions, is negotiable between agent and owner.

The author knows of one case (a ten-legged exchange) where the broker represented four parties and was very adequately compensated by all four.

In a tight money market, an exchange can affect the transfer of large equities with very little cash changing hands.

In addition to being well versed in the real estate business and tax oriented, an exchange agent must be very patient, particularly in multi legged exchanges with their attendant delays. Patience will help put the package together. It can be inferred from the above that 3 or 4 “big” exchanges a year can keep the agent fully involved.

Mortgage Loan Brokerage

In California, a real estate broker license is required for arranging or making certain real estate loans. Fees charged by brokers for arranging loans may be restricted by law. These fee restrictions apply to low balance loans secured by real property. These “legal limit” loans restrict the broker to costs and commissions set by law, depending on amount of loan, term of loan, and whether it is primary financing (first trust deed or mortgage) or secondary financing (one subordinate to the first).

Costs and commissions on loans above the legal low balance thresholds are negotiable and not set by law.

Lenders, such as commercial banks, insurance companies, savings and loans, and other “thrifts,” are governed by multiple federal government agencies and not by the Department of Real Estate as mortgage loan brokers are. However, whether as a licensee working in loan brokerage, or a non licensee operating as loan officer or counselor for the various financial and institutional lenders, a knowledge of current money market conditions, locally, statewide, nationally, and now, even internationally, is a MUST.

An experienced loan officer has a thorough knowledge of FHA, VA and conventional loans and their processing. He/she also understands the primary and secondary mortgage markets (i.e., where the money comes from and the sources of funds for real estate investments). He/she knows the markets’ relationships (i.e., competitiveness as to yield of stocks, bonds, mutual funds, and other money market instruments). He/she also has a grasp of risk analysis with both borrower and property, and a detailed knowledge of the terms and conditions of security devices (generally trust deeds in California) and promissory notes

Property Management

A property manager is engaged in the management of a real estate project, development, or buildings as distinguished from a real estate portfolio or real estate partnership, discussed below.

A property manager’s functions include managing, leasing, and maintenance of the client’s properties. He/she constructs and adjusts rent schedules, collects rents and other income (such as vending machine income), deposits and disburses funds. The hiring, training and supervision of assistant managers and resident managers fall to the property manager.

A periodic inspection schedule for ongoing maintenance and repair are a necessity in management of both small and large properties. Periodic accounting and status reports of the property(ies) are given to the client, according to the management contract.

With the advent of large real estate syndicators - many national in scope - there is a need for well-trained property managers to manage the partnership’s properties.

The Institute of Real Estate Management (IREM), confers the Certified Property Manager (CPM) professional designation on those individuals meeting the experience and educational requirements of the Institute of Real Estate Management.

The property manager must be aware of competitive rental schedules in the area and current real estate trends.

Some full service brokerage firms maintain separate property management divisions. Properties under management eventually will be sold or exchanged, and the property management division thus serves to augment the activity of real estate sales and investment departments.

Appraising

Since the early 1990's, when the Federal government created stringent rules governing the education and experience required to give a "Certified Appraisal" and testify in court, the appraisal business has become even more unique. Most appraisers in California are licensed not only under the recently created laws governing appraisers, but they are also licensed as brokers, and many are also members of organizations which confer professional designations. An appraiser, by means of training, experience and continuing education, is one who is qualified to render a professional estimate or opinion of value of real estate. The appraiser operates as an employee of a company (savings and loan, commercial bank, mortgage company or appraisal firm), a governmental entity (assessor's office, highway department), or is an independent fee appraiser. Inasmuch as an appraiser establishes "an estimate or opinion of value as of a given date," the appraiser's experience, judgment, independence and integrity are key qualifications. The usual path to success in their field is to affiliate with a professional organization and prepare for a professional designation while gaining experience.

The **Appraisal Institute**, organized in 1932, serves as the nation's largest professional organization of real estate appraisers.

AI-GRS: Appraisal Institute General Review Specialist (new 2014)

AI-RRS: Appraisal Institute Residential Review Specialist (new 2014)

MAI: Member of the Appraisal Institute

RM: Residential Member

SRA: Senior Residential Appraiser

SRPA: Senior Real Property Appraiser

SREA: Senior Real Estate Analyst



There are many other worthy appraisal organizations that provide educational materials for members (and non members) to review appraisal reports and demonstration reports of members and candidates. They recognize professional services and academic preparation by way of conferring designations on qualifying members. Each enforces a strict code of ethics.

Usually, the first thing a seller, buyer, lender, executor of an estate, assessor, insurance carrier, or other client wants to know is: "What's the property worth?"

A qualified appraiser is able to tell the client in an appraisal report explaining the value estimate in clear language.

The appraiser must have a good knowledge of real estate law and land economics law because in every “subject property” there is a legal bundle of rights (interests) and the legal interest to be appraised must be clearly defined. It may be a fee simple interest or a life estate (ownership interests), or a leasehold or easement (see the chapter on real property). Appraisal is also presented in a separate chapter for a clarification of these terms.

Whatever the interest, the economic or beneficial ownership of the client must be defined legally and precisely, so that the client and appraiser are agreed upon the extent of the interest to be evaluated. This also helps to determine the fee. The beginner appraiser will soon discover that much of the language of appraising is the language of economics.

Real Estate Counselor

In a sense, real estate brokers and salespeople engage in counseling services when clients ask questions. However, let’s look to the standards Counselors of Real Estate (CRE), originally the American Society of Real Estate Counselors (ASREC), states its definition of a **Real Estate Counselor**: “The Real Estate Counselor provides competent, disinterested, and unbiased advice, professional guidance, and sound judgment on diversified problems in the broad field of real estate involving any and all segments of the business.”

Some of these segments include merchandising, leasing, appraising, managing, planning, financing, testifying in court, and other similar services. The counselor provides services either on a fixed fee basis commensurate with the value of the services or on a commission contingent on the accomplishment of a specific transaction, like the professional real estate agent.

A real estate counselor needs a broad understanding of the entire spectrum of the real estate industry. The counselor’s clients may be sellers, buyers, developers, landlords, commercial and industrial tenants, even real estate brokers with thorny problems.

In the pursuit of his/her business, the counselor may conduct a feasibility study for a developer to determine suitability of land for development, advise a tentative limited partner in a real estate syndication as to risks involved for a buy decision, or advise an industrial giant as to whether to locate a branch plant in a particular area.

The route to real estate counseling is usually a long, diversified experience in real estate. A business degree or a M.B.A. would be a plus.

Regulations of the Real Estate Commissioner

The Real Estate Commissioner has no jurisdiction over unlicensed people.

The Real Estate Commissioner is not interested in the day to day operation of a real estate company except as it relates to broker/salesperson and broker/principal relationships and trust funds and accounting practices.

Brokerage Operations

The **company dollar** is the remainder of the sales commission after the broker has shared with a cooperating broker and the licensed sales agents in his/her office.

The desk cost includes the total current costs including salaries paid to the office manager and receptionist divided by the number of agents in the office, If you subtract the **desk cost** from the company dollar you get the broker's net income before taxes.

One of the highest cost items is advertising. To be effective, advertising must produce results. The four elements of a successful ad are attention, interest, desire and action. Very little real estate advertising is now done in the classified section of the newspaper.

Trust Fund Accounts

Trust fund legislation targets irresponsible brokers that commingle a client's money with office receipts instead of segregating them. Only clients' monies should be placed into a trust account. This action, in effect, safeguards the clients' monies in case of a civil action.

Brokers sometimes committed the act of **conversion** which is the use of client or customers' funds for the company or personal needs.

If the agreement authorizes the broker to accept a deposit from the purchaser, the broker holds the deposit as agent of the seller, and the risk of loss by the wrongful and negligent act of the broker will rest on the seller.

A broker may accept a deposit in any form. It can be cash, a check, a note, or a piece of personal property such as jewelry or title to an automobile. The broker must inform the seller of the nature of the deposit and receive consent to accept the deposit.

Trust Fund Handling

A broker places funds accepted on behalf of another:

- ▢ Into the hands of the owner of the funds.
- ▢ Into a neutral escrow depository.
- ▢ Into a trust fund account in the name of the broker as trustee at a bank or other financial institution, for the benefit of the buyer and seller in a sale transaction or the beneficiary and trustee in a loan transaction, not later than three business days following receipt of the funds by the broker or the broker's salesperson.

The account into which the trust funds are deposited shall not be an interest-bearing account for which prior written notice can, by law or regulation, be required by the financial institution as a condition to the withdrawal of funds.



A check received from the offeror may be held uncashed by the broker until acceptance of the offer if:

- the check, by its terms, is not negotiable or if the offeror (buyer) has given written instructions that the check shall not be deposited nor cashed until acceptance of the offer, and
- the offeree (seller) is informed that the check is being held before or at the time the offer is presented for acceptance.

In these circumstances, if the offeror's check was held by the broker until acceptance of the offer, the check shall be placed into the trust fund account, or into the hands of the offeree if offeror and offeree expressly so provide in writing, not later than three business days following acceptance of the offer unless the broker receives written authorization from the offeree to continue to hold the check.

The real estate broker must be designated as trustee of the trust account and all trust fund accounts must provide for withdrawal of funds without previous notice only for the benefit of the principal to whom the funds belong, or for compensation only with the permission of the principal (e.g., withdrawal of a offeror's deposit to be placed into an escrow account following acceptance or withdrawals of monies to pay taxes, insurance, utilities and repairs and compensation by a property manager). Like all good accounting practices, voided checks are to be maintained together with cashed checks for the period demanded by the Federal government for income tax verification.

Withdrawals from the trust account can be made only upon the signature of the broker or upon the signature of at least one of the following persons when authorized by the broker:

- A salesperson in the broker's employ
- Any corporate officer through whom the corporation is licensed as a broker
- Any unlicensed employee provided such employee is covered by a sufficient fiduciary bond.

Trust Account Records

The broker must maintain a columnar cash receipts and cash disbursements journal, a separate record for each beneficiary or transaction and a separate record for each property managed by his/her office. Records must be kept for all money that comes into a broker's possession. Maintenance of journals of account cash receipts and disbursements, or similar records, on automated data processing systems, including computer systems shall constitute compliance with this subdivision. The broker, with twenty-four hours of notice shall have these records available for audit by the Real Estate Commissioner.

Monies deposited by the buyer into an escrow account that do not pass through the broker's hands need not be accounted for in the broker's records.

Each broker who maintains a formal trust cash receipts journal and formal cash disbursement journal or other similar records, or uses an automated data processing system in accordance with sound accounting principles, is deemed to have complied with the law requirements.

Contracts

Principals

No licensee shall solicit, accept or execute any contract, writing or other document relating to a real estate transaction or escrow in connection therewith which contains any blank to be filled in after signing or initialing such contract, writing or other document.

A true copy of the original or corrected contract, writing or other document referred to must be given to the person signing or altering any such contract, writing or other document at the time of signing or initialing the original or the corrected contract.

A licensee must disclose to all purchasers or prospective purchasers, and to all sellers, or prospective sellers, or parties to an exchange, any and all knowledge he/she may have, as soon as it may be practical for him/her to do so, of any infestation of wood destroying organisms in any improvement on premises, the sale, purchase or exchange of which is negotiated by him/her.

Broker/Salesperson

The Commissioner's Regulations require that every real estate broker shall have a written agreement with each of his/her salespeople, whether licensed as a salesperson or as a broker under a broker/salesperson arrangement. Though the content of the contract is mandated by law, the contract itself need not be approved by the Real Estate Commissioner. The agreement shall be dated and signed by the parties and shall cover material aspects of the relationship between the parties, including supervision of licensed activities, duties and compensation. The broker need not retain a copy of this agreement following the discharge or voluntary transfer of a salesperson or broker associate. Each broker should set their own retention policy.

Broker Supervision

A broker shall exercise reasonable supervision over the activities of his/her salespersons. Reasonable supervision includes, as appropriate, the establishment of policies, rules, procedures and systems to review, oversee, inspect and manage:

- a. Transactions requiring a real estate license.
- b. Documents which may have a material effect upon the rights or obligations of a party to the transaction.
- c. Filing, storage and maintenance of such documents.
- d. The handling of trust funds.
- e. Advertising of any service for which a license is required.
- f. Familiarizing salespersons with the requirements of federal and state laws relating to prohibition of discrimination.
- g. Regular and consistent reports of licensed activities of salespersons.

The form and extent of such policies, rules, procedures and systems shall take into consideration the number of salespersons employed and the number and location of branch offices.

A broker shall establish a system for monitoring compliance with such policies, rules,

procedures and systems. A broker may use the services of brokers and salespersons to assist him/her so long as the broker does not relinquish his/her overall responsibility for supervision of the acts of salespersons licensed to him/her or her.

Legal Action to Collect Commission

The Department of Real Estate has no jurisdiction over action for recovery of commissions. Suit for such recovery must be brought in civil court, and in such suit, the broker must first show that he/she was a duly licensed real estate broker at the time of the transaction.

The Department of Real estate recognizes that a “finder’s fee” commission can be paid to an unlicensed individual as long as the “finder” does nothing but introduce the parties.

Salespersons cannot bring suit for recovery of a commission due from a seller upon their own behalf, but only through their employing broker.

Salesperson Responsibility

As an employee of the broker, a real estate salesperson is subject to the obligation created by a fiduciary relationship. The salesperson is bound by the same Law of Agency that binds the employing broker. The act of a salesperson becomes the act of their broker. Violation may cause the salesperson to lose their license and may cause the salesperson’s broker to be held responsible under civil law for his/her actions.

Cooperating Brokers

Oral agreements between cooperating brokers for a division of commission are legal. It has been ruled that they do not come within the Statute of Frauds. When an assisting broker’s services are completed, he/she is entitled to recover a commission from the cooperating broker in civil court, if necessary. In the case where the listing broker fixed the compensation at a certain sum, he/she cannot defeat the assisting broker from receiving a share of the commission by settling with the principal for a lesser sum.

State Workers’ Compensation

It is compulsory that every employer, who has one or more persons employed, shall provide workers’ compensation insurance covering accidents or disease contracted during the employee’s occupation. Such coverage may be secured in either of the following ways:

1. By insuring and keeping insured for full coverage with an authorized compensation insurance carrier.
2. By obtaining a certificate to self insure from the Director of Industrial Relations.

To obtain the certificate of consent to self insure, the employer will be required to furnish security in the form of a surety bond, or collateral that is approved by the Director of Industrial Relations in an amount he/she determines.

The law requires that the policy be written according to the Labor Code which provides that every employee shall receive all medical attention and hospitalization immediately including limited disability payments. Death benefits are payments to a spouse, children or other dependents if an employee dies from a work-related injury or illness. If a man dies as the result

of an accident in the course of his/her employment and leaves a widow, she can collect up to \$250,000 plus burial costs not exceeding \$10,000 after Jan. 1, 2013.

The wording of this law seems to make the real estate broker's responsibility very clear. Office employees obviously fall under the classification of those who must be covered and real estate salespersons also are covered, unless the broker has a written contract making his/her salespeople independent contractors and he/she has no control of the salesperson's time. The contract, however, would be subject to review and the actual application by the Industrial Accident Commission and the commission may interpret the contract differently than the employing broker. In view of the difficult question of law as to the legal status of a particular employee, the prudent broker will carry workers' compensation insurance on all his/her personnel to avoid the payment of medical bills and loss of income to employees injured while working within the scope of their job.

Do not confuse workers' compensation insurance with State Unemployment Insurance. Salespersons and brokers in the employ of another broker, who are paid solely by commission, are not covered by the State Unemployment Insurance laws.



Income Withholding Taxes

The Tax Equity and Fiscal Responsibility Act of 1982 provides a long-term safe harbor standard for independent contractors who are licensed real estate agents. Sales associates who comply with the requirements of this legislation will be exempt from any Internal Revenue Service (IRS) attempts to reclassify them from independent contractor to employee status.

Salesperson Acting as an Independent Contractor

The requirements for independent contractor status are:

- ▢ The individual must be a licensed real estate agent.
- ▢ Substantially all remuneration for services performed must be directly related to sales or output, rather than the number of hours worked; and
- ▢ The services of the individual must be performed pursuant to a written contract that spells out the individual's status as an independent contractor.

As has been the case for some time, the person or company for whom an independent contractor works must file a 1099 tax form with the IRS each year reporting all payments to the independent contractor, and must also present a copy of that form to the individual who

performed the services. The form must include the person's correct name and social security number.

Brokers still have the freedom to choose to hire people as employees. They can do so by agreeing to a contract specifying that the sales associate is an employee and will have applicable federal and state taxes withheld from his/her paychecks.

Self-Employment Taxes

Both brokers and salespersons who qualify as independent contractors come under the social security amendment, extending the scope of the federal social security program to provide old age benefits to self employed persons. The self-employment tax is paid by the self-employed broker or salesperson at the time of filing his/her income tax return and space will be provided on the income tax forms for the computation of self-employment taxes.

REALTOR®

Maintaining high ethical standards can be instrumental in leading a licensee to continued business success. For this reason, all licensees should be familiar with the Code of Ethics as adopted by the National Association of REALTORS® and should endeavor to follow its provisions.

The term "REALTOR®" is the distinctive and exclusive designation for those brokers who are members of the National Association of REALTORS®. The beginning words of their Code of Ethics are a well-established basis for the philosophy of our profession. They begin with "Under all is the land. Upon its wise utilization and widely allocated ownership depend the survival and growth of free institutions and our civilization." Because it is an association of equals, all REALTORS® agree to arbitrate their disputes rather than go to the expense of litigation.

Because the real estate business is so diversified in the type of property handled, sectional differences, size and scope of different brokerage offices, etc., some specialized groups have been founded within the framework of the National Association of REALTORS®. These include: the REALTORS® National Marketing Institute (RNMI), the American Institute of Real Estate Appraisers, the Institute of Real Estate Management, the Society of Industrial and Office REALTORS® (S.I.O.R.). Two of these groups, the American Institute of Real Estate Appraisers and the Institute of Real Estate Management, permit their members to use a type of professional designation. In AIREA, the designation is MAI (Member Appraisal Institute), in IREM it is CPM (Certified Property Manager).

Realtists®

A Realtist® must be a member of a local board as well as a member of the national organization, National Association of Real Estate Brokers. Both nationally and locally Realtists® are working for better housing for the communities they serve. In many cases, individuals are both REALTORS® and Realtists® by virtue of voluntary dual membership.

Summary of Some Sections from the Real Estate Law

General Provisions

The term **advance fee** as used in this part is a fee claimed, demanded, charged, received, collected or contracted for advertising a listing in a publication, issued primarily for promoting the sale or lease of business opportunities or real estate or for referral to real estate brokers or salespersons, or both. It also applies to the soliciting of borrowers or lenders for, or to negotiate loans on, business opportunities or real estate.

The term listing as used in this part includes, but is not limited to:

- ▢ The name or a list of the names of the owners, landlords, exchangers or lessors or the location or locations of property or of an interest in property offered for rent, sale, lease or exchange.
- ▢ The name, or a list of the names, or the location or locations at which prospective or potential purchasers, buyers, lessees, tenants, or exchangers of property may be found or contacted.
- ▢ An agreement by which a person who is engaged in the business of promoting the sale or lease of business opportunities or real estate agrees to render to an owner or lessee of such property, any services to promote the sale or lease of said property.
- ▢ An agreement by which a person who is engaged in the business of finding, locating or promoting the sale or lease of business opportunities or real estate, agrees to circularize, notify or refer real estate brokers or salespersons, or both, to said property which is offered for sale or lease.

Trust deed or **deed of trust** as used in this law, includes **mortgage**.

A real property sales contract, as used in this law is an agreement wherein one party agrees to convey title to real property to another party upon the satisfaction of specified conditions set forth in a contract which does not require conveyance of title within one year from the date of its formation.

As used in this law, the words **business opportunity** include the sale or lease of the business and good will of an existing business enterprise or opportunity.

The Real Estate Commissioner

The chief officer of the California Department of Real Estate (DRE) is the Real Estate Commissioner.

It is the principle responsibility of the Commissioner to enforce all the provisions in this law.

The Commissioner shall be appointed by the Governor.

The Commissioner shall have been, for five years, a real estate broker actively engaged in business as such in California, or shall possess related experience associated with real estate activity in California for five years in the last ten years.

The Commissioner shall receive an annual salary as provided in the Government Code, to be paid monthly out of the State Treasury upon a warrant of the Controller, and must be allowed his/her actual and necessary expenses in the discharge of his/her duties.

The Commissioner has full power to regulate and control the issuance and revocation both temporary and permanent of all licenses to be issued under the provisions of this law, and to perform all other acts and duties provided in this law and necessary for enforcement.

The Commissioner shall employ such deputies, clerks and employees as he/she may need to discharge in proper manner the duties imposed upon him/her by law.

After qualifying as such, neither the Commissioner nor any of the deputies, clerks or employees of the department shall be interested in a mineral, oil or gas business, mineral, oil or gas brokerage firm, real estate company or any real estate brokerage firm in any capacity whatsoever.

Deputies, clerks and employees shall perform such duties as the Commissioner shall assign to them.

Each deputy shall, after his/her appointment, take and subscribe to the constitutional oath of office and file the same in the office of the Secretary of State. Each clerk and employee shall take such oaths as may be required by law.

The Commissioner shall have his/her principal office in the city of Sacramento and may establish branch offices in the city and county of San Francisco, the city of Los Angeles and in such other cities as the Commissioner may deem necessary, subject to the approval of the Department of Finance.

The Commissioner shall adopt a seal with the words "Real Estate Commissioner, State of California," and such other device as the Commissioner may desire engraved thereon, by which he/she shall authenticate the proceedings of his/her office.

The Attorney General renders to the Commissioner opinions upon all questions of law that may be submitted to him/her by the Commissioner. The Attorney General shall act as the attorney for the Commissioner in all actions brought by or against him/her under any of the provisions of this statute.

The Commissioner may adopt amend, or repeal such rules and regulations enforcement of the provisions of this statute. Such rules and regulations shall be adopted, amended, or repealed in accordance with the provisions of the Administrative Procedure Act.

Whenever the Commissioner believes from evidence satisfactory to him/her, that any person has violated or is about to violate any of the provisions of this statute, he/she may bring an action in the name of the people of the State of California, in the Superior Court of the State of California against such person. He/she may enjoin such person from continuing such. However, no preliminary injunction or temporary restraining order shall be granted without at least five days' notice to the opposite party.

The Commissioner may publish or cause to be published at appropriate intervals, a directory of licensed brokers and salespersons and may publish therewith such matter as he/she may deem pertinent to this law. He/she shall furnish one copy of such directory to each licensed broker upon request and the payment of an appropriate charge based upon cost of publication.

The Commissioner may periodically issue a bulletin containing matters relating to the department and the administration thereof, and may publish the same character of matter in any established periodical published in the State.



Advance Fee Regulations

Any real estate broker who collects an **advance fee** from any other person must have all materials used in advertising, promoting, soliciting and negotiating the advance fee agreement submitted to DRE not less than ten days before use. DRE must first inform the broker that it has no objection to the advance fee agreement and material used by the broker.

Amounts may be withdrawn there from for the benefit of the agent only when actually expended for the benefit of the principal or five days after the verified accounts mentioned hereafter have been mailed to the principal. Each principal shall be furnished a verified accounting, in a form prescribed by the Commissioner, at the end of each calendar quarter and when the contract has been completely performed by the licensee.

The Commissioner may require that any materials used in obtaining advance fee are reasonably necessary for the advance fee agreements. Advertising must be presented to the Commissioner at least ten calendar days before they are used.

Monies received for advance fee promotions must be deposited in the broker's trust account when collected. He/she must render an accounting to his/her principal every calendar quarter. He/she may disperse the funds when they have been expended for the benefit of the principal or five days after the accounting mentioned has been mailed to the principal.

No person shall engage in any activity after receiving an order in writing from the Commissioner directing him/her to desist and refrain from so doing, and stating that in the opinion of the Commissioner, such activity violates a provision of this law.

Hearings

Before denying, suspending or revoking any license, the Commissioner shall proceed as prescribed in the Administrative Procedure Act of the Government Code.

An accusation shall be filed not later than 3 years from the occurrence of the grounds for disciplinary action for mistake or incompetence. If the charges involve fraud, misrepresentation or a false promise, the accusation shall be filed within one year after the date of discovery by the aggrieved party, or within three years after the occurrence thereof, whichever is later except that in no case shall an accusation be filed later than 10 years from the occurrence of the alleged grounds for disciplinary action. An acquisition called a “statement of issues” as defined in Section 11504 of the Government Code shall be filed and served upon the respondent with the order of suspension. The respondent shall have 30 days after service of the order of suspension and statement of issues in which to file with the commissioner a written request for hearing on the statement of issues filed against him/her. If a broker’s license is suspended following a hearing, all sales-person’s licenses are unusable until the suspension is lifted. All commissions earned prior to the suspension (when the license was in force) must be paid. Effectively, the broker under suspension is out of business and, in the normal course of business, the salespeople relocate their licenses with other brokers in the community.

It is unlawful for any person to engage in the business, act in the capacity of, or to advertise or assume to act as a real estate broker or a real estate salesperson within this state without first obtaining a real estate license from the Department of Real Estate.

The Commissioner may refer a complaint for violation of this section before any court of competent jurisdiction.

It is the duty of the District Attorney for each county in the State to prosecute all violations of this section in their respective counties in which the violations occur.



Real Estate Broker

A real estate broker is a person or corporation, who in expectation of a commission, does or negotiates to do one or more of the following acts:

- Obtains listings of, or negotiates the purchase, sale or exchange of real property or a business opportunity.
- Leases, rents, collects rents on real property or a business opportunity.
- Assists in filing an application for the purchase or lease of lands owned by the state or federal government. (**Land Locator**)
- Solicits borrowers or lenders for, or negotiates loans or collects payments for note owners on real property, or on a business opportunity.

- Sells, buys or exchanges a real property sales contract or a promissory note secured directly or collaterally by a lien on real property or a business opportunity, and performs services for the holders thereof.

The real estate code does not apply to the manager of a hotel, motel, trailer park, or to the resident manager of an apartment building. Should the manager manage more than one building, a license is required.

A real estate broker is also a person who engages as a principal “in the business” of buying from, selling to, or exchanging with the public, real property sales contracts or promissory notes secured by trust deeds on real property, or who makes agreements with the public for the collection of payments or for the performance of services in connection with real property sales contracts or promissory notes secured by trust deeds on real property.

Brokers who arrange (broker), fund, or service one or more residential mortgage loans in a year must complete the Business Activity Report. The Business Activity Report includes loan activity from all of a broker’s agents and MLOs.



A real estate broker is also a person who engages “in the business” of collecting an advance fee in connection with any employment undertaken to promote the sale or lease of real property or of a business opportunity.

A non resident of California may become a real estate broker by conforming to the provisions of this law.

A real estate salesperson is a natural person who, for a compensation or in expectation of a compensation, is employed by a licensed real estate broker to do one or more of the acts that a broker can do as set forth elsewhere in this law.

The following acts described in the Real Estate Code are not acts for which a real estate license is required if performed by:

- A regular officer of a corporation or a general partner of a partnership with respect to real property owned or leased by a corporation or partnership.
- A person holding a duly executed power of attorney from the owner of the real property with respect to which the acts are performed.
- An attorney at law rendering legal services to a client.

- A receiver, trustee in bankruptcy or other person acting under order of a court of competent jurisdiction.
- A trustee for the beneficiary of a deed of trust when selling under authority of that deed of trust.

The exemptions stated above are not applicable to a person who uses or attempts to use them for the purpose of evading the provisions of this law.

The need to have a real estate license does not apply to any person or employee acting as an authorized representative or agent of a corporation. This applies only to a corporation doing business as a bank, trust company, savings and loan association, industrial loan company, pension trust, credit union, insurance company, attorney, personal property broker, consumer or, commercial finance lender, farm cooperative and cemetery authority which is authorized to do business in California.

The need to have a real estate license does not apply to any person acting as an authorized representative, or loan correspondent for a bank, savings and loan, insurance company, etc., or when making loans qualified for sale to any of these businesses.

The provisions of this law requiring a license do not apply to any stenographer, bookkeeper, receptionist, telephone operator or other clerical help in carrying out their functions as such.

When a lease or leasing is referred to in this article, it includes any lease whether such lease is the sole transaction involved, or the principle part, or any incidental part of the transaction involved.

No person engaged in the business of acting in the capacity of a real estate broker or a real estate salesperson within the State shall bring or maintain any action in the courts of this State for the collection of compensation for the performance of any of the acts mentioned in this article without alleging and proving that they were a duly licensed real estate broker or real estate salesperson at the time the alleged cause of action arose.

It is unlawful for any licensed real estate broker to compensate, directly or indirectly, any person who is not a licensed real estate brokers, or real estate salesperson licensed under that broker.

The offering of premiums, prizes, merchandise discounts or other inducements to list or sell is not, in itself, unethical even if receipt of the benefit is contingent on purchasing through the broker making the offer.

No real estate salesperson can be employed by or accept compensation from any person other than the broker under whom he/she or she is licensed. The act of a salesperson becomes the act of their broker. All listings obtained by a salesperson, while under the jurisdiction of a broker, become the property of that broker.

It is unlawful for any licensed real estate salesperson to pay any compensation for performing any of the acts within the scope of this law to any real estate licensees except through the broker under whom they are at the time licensed.

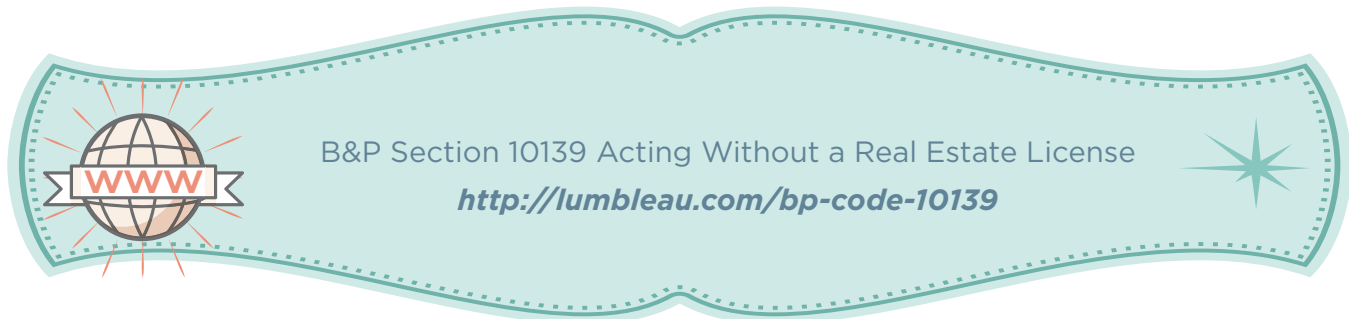
For a violation of any of the provisions of this section the Commissioner may temporarily suspend or permanently revoke the license of the real estate licensee, in accordance with the provisions of the law relating to hearings.

Nothing contained in this division shall preclude a partnership from performing acts for which a real estate broker license is required, provided every partner through whom the partnership so acts is a licensed real estate broker.

It is a misdemeanor, punishable by a fine for each offense, for any person whether obligor, escrow holder or otherwise, to pay or deliver to anyone a compensation for performing any acts within the scope of this statute, who is not known to be or who does not present evidence to such pay or that he/she is a regularly licensed real estate broker at the time such compensation is earned.

For a violation of any of the provisions of this section, the Commissioner may suspend or permanently revoke the license of the real estate licensee in accordance with the provisions of this part relating to hearings.

Any person acting as a real estate broker or real estate salesperson without a license or who advertises using words indicating that he/she or she is a real estate broker without being so licensed shall be guilty of a public offense punishable by a fine or by imprisonment in the county jail for a term not to exceed six months, or by both fine and imprisonment.



An applicant who is named on a certified list or supplemental list of the Family Code (Section 17520) because court ordered child support payments are not current shall pay a special fee in the amount of ninety five dollars for each time his/her name is placed on such list. DRE will issue a 150-day license to allow the applicant to obtain a release from the Department of Child Support Services during the 150 days.

If the DRE receives a notice that an existing licensee is over four-month delinquent in child support payments, the licensee will be advised that that their license will be suspended if the delinquency is not cleared with 150 days. The license will remain suspended until the delinquency is cleared.

Within one month after the closing of a transaction in which title to real property or the sale of a business is conveyed through a licensed real estate broker, the broker must inform both seller and purchaser, in writing, of the final selling price. If the transaction is closed through escrow and the escrow holder renders a closing statement which reveals such information that shall be deemed compliance with this section on the part of the broker.

Within one week after the closing of a sale involving the creation of a new deed of trust secured by real property, the broker who negotiated such sale must cause the new deed of trust to be recorded, or deliver it to the beneficiary with instructions to record it, unless written instructions not to record are received from the beneficiary or delivered it to the escrow holder with instructions not to record.

When a licensee prepares or has prepared an agreement authorizing or employing such licensee to perform any of the acts for which he/she is required to hold a license, or when such licensee secures the signature of any person to any contract pertaining to such services or transactions, he/she shall deliver a copy of the agreement to the person signing it at the time the signature is obtained.

A real estate broker who accepts funds belonging to others in connection with any transaction subject to this law shall deposit all such funds which are not immediately placed into a neutral escrow depository or into the hands of the broker's principal, into a trust fund account maintained by the broker in a bank or recognized depository in this state. All funds deposited by the broker in a trust fund account shall be maintained there until disbursed by the broker with instructions from the person entitled to the funds.

A real estate broker acting as a principal shall place all funds received from others for the purchase of real property sales contracts or promissory notes secured directly or collaterally by liens on real property in a neutral escrow depository unless delivery of the contract or note is made simultaneously with the receipt of the purchase funds.

A real estate salesperson who accepts trust funds from others on behalf of the broker, shall immediately deliver the funds to the broker or, if so directed by the broker, shall place the funds into the hands of the broker's principal, into a neutral escrow depository, or shall deposit the funds into the broker's trust fund account.

If not otherwise expressly prohibited, a real estate broker may, at the request of the owner of trust funds or of the principals to a transaction from whom the broker has received trust funds, deposit the funds into an interest bearing account in a bank or savings and loan association, if a number of specified requirements are met.

No interest earned on funds in such account can directly or indirectly benefit the broker nor any person licensed to the broker. In an executory sale, lease or loan transaction in which the broker accepts funds in trust to be applied to the purchase, lease, or loan, the parties to the contract shall have specified in the contract or by collateral written agreement the person to whom interest earned on the funds is to be paid or credited.

The broker has no obligation to place trust funds into an interest bearing account unless requested to do so and unless all the specified conditions are met; nor, in any event, if he/she or she advises the party making the request that the funds will not be placed in an interest bearing account.

The broker shall maintain a separate record of the receipt and disposition of all funds described in the law, including any interest earned on the funds. Such records may be maintained in a computer.

As used in this law, **neutral escrow** means an escrow business conducted by a person licensed by law to act in this capacity.

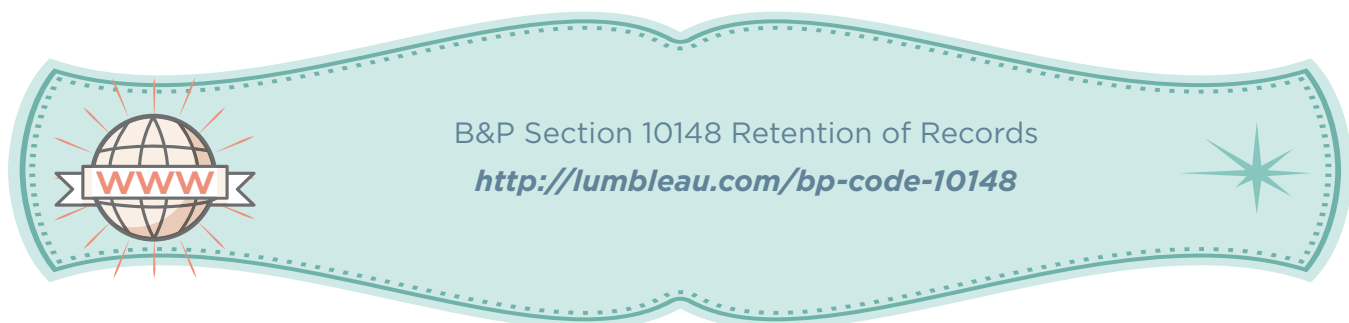
Record Retention

A licensed real estate broker shall retain, for **three years**, copies of all listings, deposit receipts, canceled checks, trust records and other documents executed by him/her or obtained by him/her in connection with any transaction for which a real estate broker license is required. The retention period shall run from the date of the closing of the transaction or from the date of the listing if the transaction is not consummated.

A real estate broker may use electronic image storage media to retain and store copies of paperwork executed by him/her or her or obtained by him/her or her in connection with any transaction for which a real estate broker license is required, provided the following requirements are satisfied:

- ▢ The electronic image storage shall be nonerasable “write once, read many” (**WORM**) that does not allow changes to the stored document or record.
- ▢ The stored document or record is preserved in the regular course of business.
- ▢ The original record from which the stored document was copied was made or prepared by the broker or the broker’s employees at or near the time of the act.
- ▢ The custodian of the record is able to identify the stored document and the mode of storing it on the electronic image storage.
- ▢ The electronic image storage system contains a reliable indexing system that provides ready access to a desired document.

Records copied and stored under this section shall be retained for three years pursuant to Section 10148 of the Code which requires the broker to maintain at the broker’s office a means of viewing copies of documents stored pursuant to this section. A broker shall provide, at the broker’s expense, a paper copy of any document or record requested by the Department.



Licenses

To obtain a real estate salesperson license, you must first qualify for and pass a written examination. Those who pass the examination are provided a license application which must be submitted to and approved by the DRE.

This license is required of individuals who conduct licensed real estate activities under the supervision of a licensed broker. A license may also be obtained by a person who does not immediately intend to be employed by a broker. However, a salesperson without a responsible broker may not perform acts requiring a real estate license.

You must be 18 years of age or older to be issued a license and must submit evidence of the successful completion at an accredited institution of three college-level courses including Real Estate Principles, Real Estate Practice, and a third course from one of the following:

- ▣ Real Estate Appraisal
- ▣ Property Management
- ▣ Real Estate Finance
- ▣ Real Estate Economics
- ▣ Legal Aspects of Real Estate
- ▣ Real Estate Office Administration
- ▣ General Accounting
- ▣ Business Law
- ▣ Escrows
- ▣ Mortgage Loan Brokering and Lending
- ▣ Computer Applications in Real Estate
- ▣ Common Interest Developments

Applicants must be honest and truthful. Conviction of a crime may result in the denial of a license. Failure to disclose any criminal violation or disciplinary action in an applicant's entire history may result in the denial of a license.

Applicants for a brokers license have similar requirements but require eight statutorily required college-level courses:

1. Real Estate Practice; and
2. Legal Aspects of Real Estate; and
3. Real Estate Finance; and
4. Real Estate Appraisal; and
5. Real Estate Economics or Accounting*; and

Three courses from the following list:

- ▣ Real Estate Principles
- ▣ Business Law
- ▣ Property Management
- ▣ Escrow
- ▣ Real Estate Office Administration
- ▣ Mortgage Loan Brokering and Lending
- ▣ Advanced Legal Aspects of Real Estate
- ▣ Advanced Real Estate Finance
- ▣ Advanced Real Estate Appraisal
- ▣ Computer Applications in Real Estate
- ▣ Common Interest Developments

*Note: If both Real Estate Economics and Accounting are taken, only two courses from the above group are required.



Continuing education offerings do not satisfy the college-level course requirements for this examination.

Additionally, a minimum of two years full-time licensed salesperson experience within the last five years or the equivalent is required. An applicant with a degree from an accredited four-year college or university which included a major or minor in real estate may be exempt from the two-year salesperson experience requirement. This may be verified by submitting a copy of the transcript showing the degree earned. Degrees and certificates earned from two-year institutions do not qualify.

Members of the California State Bar are statutorily exempt from the college-level course requirements. Evidence of admission to practice law in California must be furnished, such as a photocopy of both sides of a California State Bar Membership card. However, members of the California State Bar would still need to demonstrate that they have satisfied the two years full-time licensed salesperson experience requirement or have at least two years real estate related experience while practicing law in California.

As of January 1, 2016, proof of legal presence in the United States from all applicants for a license is not required. Applicants are required to provide a social security number or an individual identification number for licensure.

Non-resident applicants for a real estate license, in submitting their application for the license, must also file an irrevocable consent to service with the Real Estate Commissioner. This consent agreement provides that, should action need be taken against the non resident licensee, the Commissioner, after reasonable efforts to locate the licensee are unsuccessful, shall deliver the process to the Secretary of State of California. This would constitute a legal service on the licensee and the case could proceed.

The commissioner may require any other proof he/she may deem advisable concerning the truthfulness of any applicant for a real estate license (e.g., fingerprints may indicate a criminal background requiring a further investigation of an applicant).

In addition to the proof of honesty and truthfulness required of any applicant for a real estate license, the Commissioner shall ascertain by written examination that the applicant, and in the case of a corporation applicant for a broker license, that each officer or agent thereof through whom it proposes to act as a licensee, has:

- appropriate knowledge of the English language, including reading, writing and spelling, and of arithmetical computations common to real estate and business opportunity practices,
- an understanding of the rudimentary principles of real estate and business opportunity conveyancing, the general purposes and general legal effect of agency contracts, deposit receipts, bills of sale, deeds and mortgages, land contracts and leases, and of the principles of business and land economics and appraisals; and
- a general and fair understanding of the obligations between principal and agent, of the principles of real estate and business opportunity practice and the canons of business ethics pertaining thereto, as well as the provisions of this law and the commissioner's regulations.

All real estate broker and salesperson licenses issued by the Commissioner shall be for a period of four years. Applicants must qualify in the appropriate examination and satisfy all other requirements prior to the issuance of the license. The four-year license may be renewed upon filing the required application and fee and complying with the provisions regarding the completion of continuing education courses.



When an applicant for real estate license fails the qualifying examination, he/she may apply for reexamination by filing the appropriate application and fee. The application and fee for reexamination shall be filed and the reexamination taken within the two-year period following the filing date of the application.

An application on the form prescribed by the Commissioner for the renewal of a license, filed before midnight of the last day of the period for which a previous renewal license was issued, accompanied by the applicable renewal fee, entitles the applicant to continue operating under his/her existing license after its specified expiration date, if not previously suspended or revoked.

The Commissioner may issue a restricted license to a person:

- who is or has been licensed under this chapter and who has been found by the Commissioner after a hearing to have violated provisions of this code where such violation would justify suspension or revocation of the license; or
- who is applying for a license under this chapter and who has met all of the examination and experience required, but who has been found by the Commissioner, after a hearing, to have failed to have made a satisfactory showing that he/she meets all of the other requirements for the license applied for, where such failure would justify the denial of the license applied for.

A restricted license issued, as the Commissioner in his/her discretion finds advisable in the public interest, may be restricted:

- by term
- to employment by a particular real estate broker, if a salesperson
- by conditions to be observed in the exercise of the privileges granted

When issued, a restricted license does not confer any property right in the privileges to be exercised there under, and the holder of a restricted license does not have the right to renewal of such license. The Commissioner may, without hearing, issue an order suspending the licensee's right to further exercise any privileges granted under a restricted license pending final determination made after a formal hearing.

As one of the conditions to the issuance of a restricted license the Commissioner may require the filing of surety bonds by the restricted licensee for the protection of persons or classes of persons with whom said licensee may deal.

No real estate license gives authority to do any act specified in this chapter to any person other than the person to whom the license is issued.

When a real estate license is issued to a corporation, if it desires any of its officers other than the officer designated by it to act under its license as a real estate broker, it shall procure an additional license to so employ each of such additional officers.

Each officer of a corporation through whom the corporation is licensed to act as a real estate broker must be a broker and can only act for and on behalf of the corporation. No salesperson may become a director. If the Broker wishes to act independently of the corporation he/she or she must hold an active broker's license.

Every person applying for a license who desires to have such license issued under a fictitious name shall file with his/her application a certified copy of both the entry of the county clerk and the affidavit of publication made pursuant to the provisions of the Business and Professions Code.

The real estate salesperson's license shall remain in the possession of the licensed real estate broker employer until canceled or until the salesperson leaves the employ of the broker, and the broker shall make his/her license and salesperson licenses available for inspection by the Commissioner or his/her representative.

The holder of an inactive license may reinstate or renew such a license on an active basis only, provided the licensee presents evidence of compliance with all the provisions of this part and is otherwise qualified. The broker cannot actively participate in the real estate business while the license is inactive.

Business and Residence Addresses of Licensees

Every broker, except a broker acting in the capacity of a salesperson to another broker under written agreement, shall maintain on file with the commissioner the address of his/her principle place of business for brokerage activities, the address of each branch business office and his/her current mailing address, if it is different from the business address.

A real estate salesperson shall maintain on file with the commissioner his/her current mailing address, and when applicable, the address of the principle business office of the broker to whom the salesperson is at the time licensed. Whenever there is a change in the location or address of the principle place of business or of a branch office of a broker, he/she shall notify the commissioner thereof not later than the three business days following the change.

Notice of changes in license information or status is required to be submitted to the Department and shall be given on forms prescribed by the DRE not later than five days after the effective date of the change.

Whenever a real estate sales person enters the employ of a real estate broker, the broker must immediately notify the Commissioner in writing. The sales person must also notify the Commissioner if the transfer is from an inactive status. The salesperson may start working for the broker immediately.

Whenever employment of a real estate salesperson is terminated, the broker must immediately notify the Commissioner in writing.



B&P Section 10161.8 Commissioner Notifications
<http://lumbleau.com/bp-code-10161.8>



Every licensed real estate broker, either natural or incorporated, shall maintain a place of business in the State of California. The “place of business” can be from a broker’s residence as well as from a commercial space. The only requirement is that it have an address and not be a post office box. If a broker has branch offices, all salesperson’s licenses will be located at the main office address.

If the applicant for a real estate broker’s license maintains more than one place of business within the state, he/she shall apply for and procure an additional license for each branch office so maintained by him/her. Every such application shall state the name of the person and the location of the place or places of business for which such license is desired. The commissioner may determine whether or not a real estate broker is doing a real estate brokerage business at or from any particular location which requires him/her to have a branch office license.

Prepaid Rental Listing Service

The business of supplying prospective tenants with listings of residential real properties for tenancy by publication or otherwise with the understanding that the prospective tenant is required to pay a fee in advance of, or at the time of delivery of the listings, is known as a prepaid rental listing service. These specialists do not become involved in the negotiation of leases. They are in the referral business.

A broker’s license or a **Prepaid Rental Listing Service (PRLS)** license is required to engage in the business of a prepaid rental listing service. Additionally, a separate application for a license is required for each location if operated by a licensee other than a real estate broker.



PRLS requirements
<http://lumbleau.com/PRLS-Requirements>



It is a violation of real estate law if licensees in this business refer a property to a prospect knowing that: (a) the property does not exist or is unavailable for rent; (b) the property has been represented in a false, misleading and deceptive manner; (c) the licensee had not confirmed the availability of the property for tenancy during the four day period immediately

prior to making the referral; (d) the licensee had not obtained permission, oral or written, to list the property from the property owner, manager or other authorized person.

The prepaid rental listing service licensee, other than a real estate broker, is required to refund the entire prepaid (advance) fee if the licensee fails to supply the prospective tenant with at least 3 suitable rental properties within 5 days of executing their agreement. If no rental is obtained by the prospect within the agreement period, all money above the sum of \$50 must be refunded. The prospective tenant must demand the refund in either case within ten (10) days of the termination of the contract.

The Commissioner may suspend or revoke the license of a prepaid rental listing service or the license of the service to operate at one or more locations for: 1) a violation of the provisions of this law by a licensee or employee or agent, including the designated agent of the licensee; 2) a conviction of a licensee or an officer, director or owner of 25% or more of the shares of a corporate licensee for a crime which is related to this kind of rental service.



Continuing Education

All salesperson and broker license renewals on or after 1/1/2016 require completion anytime during the four-year period preceding the renewal of a **DRE approved 45 hours of continuing education courses** that include:

- ▢ Six separate three-hour courses in Ethics, Agency, Trust Fund Handling, Risk Management, Fair Housing, and Management & Supervision.
- ▢ A minimum of 18 hours of consumer protection
- ▢ The remaining clock hours needed to complete the 45 hours of continuing education may be related to consumer service or consumer protection.

Salespersons renewing for the first time are not required to complete the Management & Supervision course but are required to complete a total of 45 hours continuing education.

Salespersons and brokers renewing for the second and subsequent times may substitute an eight-hour survey course covering the six mandatory subjects (Ethics, Agency, Fair Housing, Trust Fund Handling, Risk Management and Management & Supervision) provided they complete a minimum of 18 hours in consumer protection with the balance in consumer protection or consumer service.

A person who is licensed as a real estate broker only as an officer of a corporate broker will not be eligible for the renewal of such license nor for the issuance of a license in an individual capacity or as an officer of a corporate broker, unless and until such person has completed the continuing education requirements mentioned above.

Disciplinary Action

Upon grounds provided in this article and the other articles in this statute, the license of any real estate licensee may be revoked or suspended in accordance with the provisions of the law relating to hearings.

The Commissioner may upon his/her own motion and shall, upon the verified complaint in writing of any person, investigate the actions of any person engaged in the business or acting in the capacity of a real estate licensee within this state and he/she may temporarily suspend or permanently revoke a real estate license at any time where the licensee, while a real estate licensee, has been guilty of any of the following:

- Making a substantial misrepresentation.
- Making any false promises likely to influence, persuade or induce.
- A continued and flagrant course of misrepresentation or making of false promises through real estate agents.
- Acting for more than one party in a transaction without the knowledge or consent of all parties thereto.
- Commingling with his/her own money or property the money or other property of others which is received and held by him/her.
- Claiming, demanding, or receiving a fee, compensation or commission under any exclusive agreement authorizing or employing a licensee to sell, buy or exchange real estate for compensation or commission where such agreement does not contain a definite, specified date of final and complete termination.
- The claiming or taking by a licensee of any secret or undisclosed amount of compensation, commission or profit or the failure of a licensee to reveal to the employer of such licensee the full amount of such licensee's compensation, commission or profit under any agreement authorizing or employing such licensee.

It is a recognized fact that the compensation paid to a real estate broker may be in the form of money or any other item of value (e.g., the broker may receive land, or a trust deed or other personal property). It is also recognized that once received, should that commission gain or lose value, the gain or loss is that of the broker.

The use by a licensee of any provision in a listing allowing the licensee an option to purchase, except when such licensee prior to or coincident with election to exercise such option to purchase reveals in writing to the principal the full amount of licensee's profit and obtains the written consent of the principal approving the amount of such profit.

Any other conduct, whether of the same or a different character than specified in this section, which constitutes fraud or dishonest dealing.

Obtaining the signature of a prospective purchaser to an agreement which provides that such prospective purchaser shall either transact the purchasing, leasing, renting, or exchanging of a business opportunity property through the broker obtaining such signature, or pay a compensation to such broker if such property is purchased, leased, rented or exchanged without the broker first having obtained the written authorization of the owner of the property concerned to offer such property for sale, lease, exchange or rent.

The Commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant who has done any of the following:

- Procured or attempted to procure a real estate license, for himself/herself or any salesperson, by fraud, misrepresentation or deceit, or by making any material misrepresentation.
- Entered a plea of guilty or nolo contendere to, or been found guilty of, or been convicted of, a felony or a crime involving moral turpitude, and the time for appeal has elapsed or the judgment of conviction has been affirmed on appeal, irrespective of an order granting probation following such conviction, suspending the imposition of sentence, or of a subsequent order under the provision of Section 1203.4 of the Penal Code allowing such licensee to withdraw his/her plea of guilty and to enter a plea of not guilty, or dismissing the accusation or information.
- Knowingly authorized, directed connived at or aided in the publication, advertisement distribution, or circulation of any materially false statement or representation concerning his/her business or any business opportunity or any land or sub-division offered for sale.
- Willfully disregarded or violated any of the provisions of the Real Estate Law or of the rules and regulations of the Commissioner for the administration and enforcement of the Real Estate Law.
- Willfully using the term “REALTOR®” or any trade name or insignia of membership in any real estate organization of which the licensee is not a member (e.g., “Realtist®”).
- Acted or conducted himself/herself in a manner which would have warranted the denial of his/her application for a real estate license.
- Demonstrated negligence or incompetence in performing any act for which he/she is required to hold a license.
- If, as a broker licensee, failed to exercise reasonable supervision over the activities of his/her salespersons; or as the officer designated by a corporate broker licensee failed to exercise reasonable supervision and control of the activities of the corporation for which such license is required.
- Has used his/her employment by a governmental agency in a capacity giving access to records, or other than public records, in such manner as to violate the confidential nature of such records.

- Any other conduct, whether of the same or a different character than specified in this section, which constitutes fraud or dishonest dealing.
- Violated any of the terms, conditions, restrictions, and limitations contained in any order granting a restricted license.
- Solicited or induced the sale, lease or the listing for sale or lease, of residential property on the ground, wholly or in part, of loss of value, increase in crime, or decline of the quality of schools due to the present or prospective entry into the neighborhood of a person or persons of another race, color, religion, ancestry or national origin.
- Violated any provision of the Franchise Investment Law or regulations of the Corporations Commissioner.
- Violated any of the provisions of the Corporations Code or of the regulations of the Commissioner of Corporations relating to securities.

The Commissioner may, without hearing suspend the license of any real estate licensee who procured a real estate license for himself/herself by fraud, misrepresentation or deceit, or by making any material misstatement of fact in his/her application for a real estate license, pending final determination made after hearing. The right to suspend a license without a hearing under the provisions of this section shall expire ninety days after issuance of an original license.

When a final judgment is obtained in a civil action against any real estate licensee upon grounds of fraud, misrepresentation or deceit with reference to any transaction for which a license is required under this division, the Commissioner may, after a hearing in accordance with the provisions of the law relating to hearings, suspend or revoke the license of such real estate licensee.

When any real estate salesperson is discharged by his/her employer for a violation of any of the provisions of this article, a certified written statement of the facts with reference thereto shall be filed forthwith with the Commissioner by the employing broker and if the employing broker fails to notify the Commissioner as required, the Commissioner may suspend or revoke the real estate license.

No violation of any of the provisions of this law relating to real estate or no violation by any real estate salesperson or employee of any licensed real estate broker shall cause the revocation or suspension of the license of the employer of the salesperson or employee unless it appears upon a hearing by the Commissioner that the employer had guilty knowledge of such violation.

The Commissioner may deny, suspend, or revoke the real estate license of a corporation as to any officer or agent acting under its license without revoking the license of the corporation.

As a condition to the reinstatement of a revoked or suspended license, the Commissioner may require the applicant to take and pass a qualifying exam.

All real estate license fees shall be payable in advance of issuing the licenses and at the time of filing the application.

Unless otherwise provided, all licenses expire at midnight of the last day of the period for which issued.

All existing licenses shall be subject to renewal fees.

The holder of a license who fails to renew it prior to the expiration of the period for which it was issued and who has otherwise qualified for such license, may renew it within two years from such expiration upon proper application and the payment of a late renewal fee. (e.g., salesperson \$245, broker \$300).

The required application and fee for the license must be submitted and paid within one year from the date of the examination.

The amount of real estate fee prescribed for a license under this chapter is that fixed by the following provisions of this article. No part of any fee paid in accordance with the provisions of this chapter is refundable. It is deemed earned by the DRE upon its receipt.

The real estate broker license examination fee is \$95. The real estate broker license reexamination fee is \$95.

If an applicant fails to appear for the examination within two years from the date of filing his/her application and fee for the examination, his/her application shall thereupon lapse and no further proceedings thereon shall be taken.

The fee for a real estate broker license is \$300. In the case of an original applicant, the fee is payable after the applicant is notified of passing the examination for license.

If the licensee is a corporation, the license issued to it entitles one officer thereof, on behalf of the corporation, to engage in the business of real estate broker without the payment of any further fee, such officer to be designated in the application of the corporation for a license. For each officer, other than the officer so designated, through whom it engages in the business of real estate broker, the appropriate original or renewal fee is to be paid in addition to the fee paid by the corporation.

The real estate salesperson license examination fee is sixty dollars. The real estate salesperson license reexamination fee is \$60.

If an applicant fails to appear for the examination within two years from the date of filing his/her application and fee for the examination, his/her application will immediately lapse and no further proceedings will take place.

If an applicant for any examination fails to take the examination on the scheduled date, he/she may make application in writing to the principle office of the DRE in Sacramento for a new date. The application fee must accompany the written request to reschedule.

The fee for a real estate salesperson license shall not exceed \$240. In the case of an original applicant, the fee is payable after the applicant is notified of passing the examination for license.

Both salesperson and broker applicants must pay an additional \$49 fee directly to a live scan fingerprint service provider for the cost of fingerprinting.

For any examination required under any order issued pursuant to the provisions of the Administrative Procedure Act, the fee is \$60 dollars for salespersons and \$95 for brokers.

Real Estate Recovery Program

There shall be separate accounts in the Real Estate Fund for purposes of real estate education and research and for purposes of recover which shall be known respectively as the Education and Research Account and the Recovery account. The section “No portion of the amount of any license fee collected is credited to the Education and Research Account” was added in 1996.

If on June 30, of any year, the balance in the Real Estate Fund which is allocated for purposes other than education and research is less than \$200,000, every licensed broker shall pay an additional \$7 fee when renewing his/her license and every salesperson an additional \$4 fee. These extra fees are to be used solely for recovery purposes.



Application for Payment from Recovery Fund

When an aggrieved person obtains a final judgment against a real estate broker based upon the broker’s fraud, misrepresentation, deceit, or conversion of trust funds, the aggrieved person may, upon the judgment becoming final and after exhausting all attempts to personally recover the amount due from the broker’s personal assets, file an application with the Department of Real Estate for payment from the Recover Account.

The application shall be delivered in person or by certified mail to an office of the department and a copy served on the Judgment debtor in accordance with Section 10471.1 not later than one year after the judgment has become final.

The application shall be made on a form prescribed by the department, verified by the claimant, and shall include specified information regarding the details of the action taken against the accused licensee.

The application form shall include detailed instructions with respect to documentary evidence, pleadings, court rulings, and the products of discovery in the underlying litigation to be appended to the application.

Notice to be Served on Judgment Debtor

Not later than 15 days after submission of the application to the department, the claimant shall serve a copy of the notice prescribed in subdivision (c) upon the judgment debtor by personal service or by registered mail, together with a copy of the application.

Final Decision Settlement

The Commissioner shall render a final written decision on the application within 90 days after a completed application has been received unless the claimant agrees in writing to extend the time within which the Commissioner may render a decision. If the Commissioner fails to render a written decision in response to the claim within 90 days after its receipt or within the extended period agreed to by the claimant, the claim shall be deemed to have been denied by the Commissioner on the final day for rendering the decision.

The Commissioner may deny or grant the application or may enter into a compromise with the claimant to pay less in settlement than the full amount of the claim. If the claimant refuses to accept a settlement of the claim offered by the Commissioner, the written decision of the Commissioner shall be to deny the claim or it shall be deemed denied if a written decision is not rendered within the time specified in subdivision. Evidence of settlement shall not be competent evidence in judicial proceedings undertaken by the claimant pursuant to Section 10472 of the Business and Professions Code.



Notice of Decision

The Commissioner shall give notice of a decision rendered with respect to the claim to the claimant and to a judgment debtor who has filed a timely response to the claim.

If the application is denied, the notice to the claimant and judgment debtor shall include the following:

“Claimant’s application has been denied. If the claimant wishes to pursue the application in court, the claimant must file the application in the court in which the underlying judgment was entered not later than six months after receipt of this notice, pursuant to Section 10472 of the Business and Professions Code.”

Notice of Denial Order Directing Payment

A claimant against whom the Commissioner has rendered a decision denying an application pursuant to Section 10471 may, within six months after receipt of notice of the denial, file a verified application in the court in which judgment was entered in favor of the claimant, for an Order Directing Payment Out of the Recovery Account based upon the grounds set forth in the claimant's application to the Commissioner.

A copy of the verified application shall be served upon the Commissioner and upon the judgment debtor. A certificate or affidavit of service shall be filed by the claimant with the court. Service on the Commissioner may be made by registered mail addressed to the headquarters office of the department. Service upon a judgment debtor may be made in accordance with law.

Limitations for Any One Licensee

Notwithstanding any other provision of this chapter and regardless of the number of persons aggrieved or parcels of real estate involved in a transaction or the number of judgments against a licensee, the liability of the Recovery Account shall not exceed the following:

For causes of action, \$50,000 for any one transaction and \$250,000 for any one licensee.

License Suspension

The law establishes that should the Commissioner pay any amount from the fund in settlement of this type of claim, the license of the accused broker and/or salesperson is automatically suspended upon the date of payment. No license suspended for such a cause can be reinstated until the amount of the payment has been repaid in full plus interest at the prevailing rate for such matters. A discharge in bankruptcy will not relieve the licensee from these penalties and disabilities.

Mobilehomes

Notwithstanding any other provision of law, a person licensed as a real estate broker may sell or offer to sell, buy or offer to buy, solicit prospective purchasers of, solicit or obtain listings of, or negotiate the purchase, sale or exchange of any mobilehome only if the mobilehome has been registered under the Health and Safety Code for at least one year.

Mobilehome means a structure transportable in one or more sections, designed and equipped to contain no more than two dwelling units to be used with or without a foundation system.

It is unlawful for any licensee to:

- Advertise or offer for sale in any manner any mobilehome unless it is either in place on a lot rented or leased for human habitation within an established mobilehome park as defined in Sec. 18214 of the Health and Safety Code and the advertising or offering for sale is not contrary to any terms of a contract between the seller of the mobilehome and the owner of the mobilehome park, or is otherwise located, pursuant to a local zoning ordinance or permit, on a lot where its presence has been authorized or its continued presence and such use would be authorized for a total and uninterrupted period of at least one year.

- Fail to withdraw any advertisement of a mobilehome within 48 hours after notice that it is no longer available for sale.
- Advertise a mobilehome as new.
- Include license fees in the cost unless the licensee has paid them to prevent a penalty.
- Represent that a mobilehome can be operated as a vehicle on a highway unless it meets the requirements.
- Advertise no down payment when in fact one is required, inducing the buyer to finance such down payment by separate financing.
- Fail to make sure that the buyer receives the bill of sale and other documents.

Mobilehome License Administration is under the jurisdiction of the Department of Housing and Community Development (HCD). The document used to transfer the title is a **bill of sale**. Real estate licensees are permitted to negotiate the sale of mobilehomes which are less than a year old, provided the requirements of Section 18551 of the Health and Safety Code for transforming a mobilehome to real property have been satisfied. Under Section 18551 there are four principle prerequisites for transforming a mobilehome into real property: (1) obtaining a building permit; (2) placing the mobilehome on a foundation; (3) obtaining a certificate of occupancy; and (4) recording a document reflecting that the mobilehome has been affixed to a foundation system. Licensees who work with such properties should also be familiar with certain preconditions which must be met before a local agency can issue a building permit for such a structure.

After a mobilehome has been installed on a foundation system, it is deemed a fixture or improvement to the real property and is taxed as real property.

Attachment to a foundation system also results in other consequences for the mobilehome, its owner and for licensees. First, the mobilehome is taxable as real property. Secondly, HCD must cancel its registration and title to the mobilehome. It is thereafter registered with the county recorder where the mobilehome is located and ownership is transferred accordingly (until its removal from the foundation). Thirdly, removal from the foundation is prohibited unless prescribed conditions are met.

Mobilehomes which are sold new, but which are not attached to a foundation system and mobilehomes sold new for which vehicle license fees are 120 days or more delinquent, are taxed as personal property. Taxation as personal property is virtually indistinguishable from taxation as real property.

This law permits the buyer and the seller of a used mobilehome to agree to the proration of the license fees paid for the registration of the mobilehome. It also exempts the leasing of mobilehome park space from the Subdivided Lands Law, except in the case of leases for more than five years.

Manufactured Home

You should also know that there is yet another word used in the law and in practice to describe a “mobilehome.” In the Health and Safety Code and elsewhere in California law the designation

manufactured home describes a structure transportable in one or more sections which in the traveling mode, is eight body feet (8 ft.) or wider and forty body feet (40 ft.) or more in length, or when erected on site, is 320 or more square feet in area. It is built on a permanent chassis and is designed to be used as a dwelling with or without a permanent foundation when connected to the necessary utilities. Included in its structure are the plumbing, heating, air conditioning and electrical systems.

The term manufactured home also includes a mobilehome subject to the National Manufactured Housing Construction and Safety Act of 1974.

Real Estate Words

Each trade and profession has its own vocabulary words peculiar to that occupation and real estate is no exception. The “language” of real estate is not difficult to learn; there are no long, seemingly non understandable phrases as there are in law or medicine. Most of the words are related to common usage, but there are some that have a “real estate” meaning differing from the generally accepted definition, such as the word “several.”

In everyday use, “several” retains its familiar definition of meaning more than two but not many, as when one might say “I looked at several listings today.” In real estate, it has a special legal meaning of “separate, distinct, individual” and is used in real estate in that sense to describe ownership of real property by only one person.

From the legal profession, we also have some real estate words which we call “OR” and “EE” words. These describe the parties to a particular transaction and, depending upon whether the word ends in “OR” or “EE”, will indicate which party is intended. These include:

assignor	assignee
bailor	bailee
devisor	devisee
grantor	grantee
lessor	lessee

notes:

Chapter 1 Summary

Because the real estate housing market is varied in nature and because the housing market deals with many different types of desires and needs, it is said to be stratified. **Stratified** means different levels.

The term **REALTOR**[®] is the distinctive and exclusive designation for those brokers who are members of the National Association of REALTORS[®]. The beginning words of their Code of Ethics are a well-established basis for the philosophy of our profession. Because it is an association of equals, all REALTORS[®] agree to arbitrate their disputes rather than go to the expense of litigation. A **Realtist**[®] is a member of a local board as well as a member of the national organization. Both National Association of Real Estate Brokers and Realtists[®] are working for better housing for the communities they serve. In many cases, individuals are both REALTORS[®] and Realtists[®] by voluntary dual membership.

The Real Estate Commissioner regulates real estate brokers and their employees. The Commissioner may suspend or revoke a license for unauthorized use of the term REALTOR[®], Realtist[®], or other trade marked associations.

Commissioner's Regulations require that every real estate broker shall have a written agreement with each of his salespeople, whether licensed as a salesperson or as a broker under a broker/salesperson arrangement.

Most agents are **independent contractors** where commissions earned are directly related to sales or output, rather than the number of hours worked.

Agents can only receive commissions from their employing broker. Compensation paid to a real estate broker may be in the form of money or any other item of value (e.g., the broker may receive land, or a trust deed or other personal property).

A real estate broker may sell or offer to sell, buy or offer to buy, solicit prospective purchasers of, solicit or obtain listings of, or negotiate the purchase, sale or exchange of any mobilehome only if the mobilehome has been registered under the Health and Safety Code for at least one year. **Mobilehomes** are also known as **manufactured homes**. The document used to transfer the title is a **Bill of Sale**.

Business may only be done in California, but brokers may accept referrals and commissions from out-of-state brokers.

All records and copies of all paperwork must be kept by the broker for a minimum of **three years**.

Brokers are interested in controlling costs associated with their business. One way is to calculate **desk costs** by adding the cost of equipment, phones, rent and administrative salaries and then divide by the number of desks in the office.

Legal fees are also reduced when disputes are handled by arbitration instead of litigation as requested in the REALTOR[®] Code of Ethics.

Commingling is the mixing of broker's personal or business funds with one or more client's deposited funds that were supposed to go into a separate escrow or bank account. The more serious action of **conversion** is the use of client or customers' funds for the company or personal needs. Earnest money deposits may be in many forms including cash, checks, promissory note or items of value if it is disclosed to the seller. Brokers typically do not allow their agents to accept cash in order to avoid commingling.

Generally speaking, words ending in "OR" indicates the party doing an act or giving something to the other party; the word ending in "EE" identifies the party receiving something. A mortgagor gives a mortgage to the mortgagee who receives it. A grantor gives a deed to a grantee. A lessor gives a lease to a lessee.

chapter 1 quiz

- 1. "Because the real estate housing market is varied in nature deals with many different types of desires and needs, it is said to be:**
 - a. Structured.
 - b. Stratified.
 - c. Fractured.
 - d. Fractionated.
- 2. The desk cost for a broker is:**
 - a. The cost of equipment divided by the number of desks in the office.
 - b. The cost of equipment plus rent divided by the number of desks.
 - c. The cost of equipment, phones and rent divided by the number of desks.
 - d. The cost of equipment, phones, rent and administrative salaries divided by the number of desks in the office.
- 3. Commingling is most nearly the opposite of:**
 - a. Trust fund.
 - b. Mingle.
 - c. Segregate.
 - d. Neutral depository.
- 4. Which of the following best describes conversion?**
 - a. The broker deposits a cash deposit into his/her personal account after an offer is accepted and instructed to by the seller.
 - b. The broker receives a check from a buyer and deposits it in his/her personal account and commingles it with his/her own money.
 - c. The broker receives a check from a buyer with instructions from the buyer to hold the check until the offer is accepted.
 - d. The agent receives a \$500 cash deposit and spends it on a vacation in Nevada.
- 5. A broker may accept which of the following from a buyer for a deposit?**
 - a. Postdated check.
 - b. Unsecured promissory note.
 - c. Promissory note secured by a deed of trust.
 - d. All of the above.
- 6. Should a dispute regarding a commission arise between two REALTOR® licensees, the Code of Ethics recommends settlement by:**
 - a. Litigation.
 - b. Estoppel.
 - c. Arbitration.
 - d. Mandamus.
- 7. The document used to transfer title to a mobilehome is:**
 - a. A vehicle certificate of registration
 - b. A bill of sale.
 - c. A deed.
 - d. A compliance agreement.
- 8. As a California real estate broker an out-of-state broker refers a client to consummate a sale. Under California real estate law:**
 - a. You may pay a commission to a broker of another state.
 - b. You cannot divide a commission with a broker of another state.
 - c. You can pay a commission to a broker of another state only if he/she is also licensed in California.
 - d. None of the above.
- 9. Copies of all listings, purchase agreements, canceled checks, and trust records must be retained by a licensed real estate broker for:**
 - a. One year.
 - b. Two years.
 - c. Three years.
 - d. Five years.
- 10. Arthur Davidson, a licensed real estate broker, falsely advertises that he is a REALTOR®. Which of the following best describes this situation?**
 - a. There is nothing wrong with this.
 - b. It is a felony. A district attorney may prosecute him.
 - c. He is subject to discipline by the Real Estate Commissioner for using the word REALTOR®.
 - d. A listing obtained because of the advertisement would be void.



“This is my strategy: not to negotiate.
That is negotiation.”

— Fredrik Eklund

CHAPTER 2: *agency*

Learning Objectives

The agency relationship of an agent with his/her client is the cornerstone of the real estate industry. Statutory and case law governing this relationship provide the basic rules by which the individuals involved in the industry function in relation to others. The concept of agency itself is not a complex idea, although its use is subject to a detailed and pervasive regulatory structure as this chapter details.

key terms

Actual Agency	Gratuitous Agent	Ostensible Agency
Agent	Interpleader Action	Principal
Alquist-Priolo Special Studies Act	Known False Statement	Puffing
Dual Agency	Listing Agent	Secret Profit
Easton vs Straussburger	Material	Selling Agent
Failure to Disclose	Middleman	Strawman
Fiduciary	Misrepresentation	Subagent
	Negligent Fraud	Vicarious Liability

The Agency Relationship

Two principle legislative vehicles provide this regulation in California. All agency relationships in this state are governed generally by the California Law of Agency, a series of statutes located in the Civil Code in California. Agency relationships specific to the real estate industry are regulated by a second series of statutes, this latter series known as the California Real Estate Law. This series is located in the California Business and Professions Code. The two acts are compatible and together provide the primary guidelines for the agency relationship in real property practice. The Law of Agency tends to be fairly general while the applicable provisions of the California Real Estate Law are relatively more specific. In addition to these statutes, countless court decisions in this state (“case law”) provide an additional source of rules applicable to this unique relationship.

The Agent

An agent is nothing more (and nothing less) than an individual who is authorized to act on behalf of another. The individual on whose behalf the agent acts is referred to as the principal. Agency is the relationship between these two entities.

The laws of agency govern the rights and duties of **principal** to agent, principal to a third party and agent to a third party. Anyone other than the principal and agent is a third party to the agency relationship.

Characteristic of this relationship is the fact that the principal delegates or authorizes to the agent the right to act on behalf of the principal in specified transactions as well as to exercise discretion, to one degree or another, in carrying out the terms of the transaction. The agent acts in the stead of the principal for the purpose of bringing the principal into legal relationships with third persons.

The material in this chapter is a discussion of the duties owed by the agent to the principal and what the agent is allowed to do. Also included is what the agent is not permitted to do while representing the principal. The reader will no doubt note that, under the law in California and in other states as well, the agent is held to a much higher standard of performance than if the same individual were acting as an employee.

There are many things that an employee may do in relation to the employer that are not allowed to be done (or which must be done) by the agent in relation to the principal. The law (both the Law of Agency as well as the California Real Estate Law) imposes specific duties on agents. These specific duties are of more than academic interest; they define, to a great extent, the liability of the agent to the principal (and in some cases to third parties as well.)

Higher Standard

There are many reasons why the agent is held to a higher standard of performance than one acting in some other capacity, such as employee or independent contractor. From the time that the agency is created, the agent will be dealing with the real property of the seller. Once an offer is received the agent will then be dealing (in most cases) with the money of the buyer. Because the agent is in the position of control over the property of the seller and buyer, the law is concerned that the agent act with the appropriate degree of care.

Consider also that the agent is, by the nature of the relationship, given substantial discretion as to how the purposes of the agency may be accomplished. Because of this relative lack of control, the state provides guidelines (by statutes and case law) to assure that this discretion is exercised by the agent in a proper manner. There is, perhaps, a more immediate reason for this severe regulation, that being based on a legal theory referred to as **vicarious liability**. Vicarious liability is a concept that states:

“Under certain circumstances, one individual will be held liable for the acts of another.”

A common example of this theory and its application is found in the parent child relationship. Say, for example, your child is playing baseball in the backyard and whacks the ball with his/her bat sending it over the back fence and through your neighbor’s living room window. As the child’s parent, you are financially liable for the expense your neighbor incurs in replacing the window. Even though you were not the one who broke the window, as the parent you are the party who must bear the burden of the expense of the repair.

This same concept of vicarious liability is one of the primary characteristics of the agency relationship. The principal, the party on whose behalf the agent acts, is liable for whatever the agent does within the scope of the transaction. If the agent misrepresents a fact to the buyer, the law holds the principal liable for any financial loss suffered by the opposite party, even though the principal may have had nothing whatever to do with the misrepresentation, and possibly may even have cautioned the agent against engaging in such conduct.

Agent and Principal Considered as One

The law imposes this vicarious liability on the principal based on the unique nature of the relationship between the principal and agent. The agent and the principal are, to a substantial degree, considered by the law to be one party, the agent is, in a manner of speaking, the

clone of the principal, one and the same. The two take on a mutuality of identity. The acts of an agent, in terms of legal consequences become, in effect, the acts of the principal. The principal, it follows, has liability for the acts of the agent.

Note, however, that this liability of the principal for the acts of the agent is not true in reverse; that is, the agent is not likewise liable for the acts of the principal. Akin to the idea of vicarious liability is the fact that the agent can bind the principal to obligations to third parties; this is based upon the mutuality of identity.

To some extent, the relationship between the agent and the principal resembles that of the employee/employer. There is, however, a significant difference. The Labor Code in California defines an employee (referred to on some occasions by its more traditional designation as “a servant”) as an individual employed to render personal services to that individual’s employer (or more traditionally, “the master”), not in the pursuit of an independent calling, and who, while rendering such service remains entirely subject to the control of the employer.

The agent and the employee both work for the advantage of the employer or principal. However, the agent does more. The agent also acts in the place of the principal as to the principal’s relationship with third parties.

Many court cases speak out on the distinction between an agency relationship and that of an independent contractor. These cases universally agree that the existence of right of control and supervision is required to establish agency but, when the one who performs the service is not subject to control but is engaged to produce results by means and a manner of his/her own choosing, he/she is an independent contractor.

The Employing Broker

Consider for a moment the public perception of the real property broker. The average seller and buyer expect the broker to serve as mere “middleman.” We anticipate that the broker is going to do more than simply locate a buyer for a particular property. It would be an unusual transaction indeed if the sole responsibility of the broker is to prepare the documentation. The broker is not generally considered by either the public or the law to be nothing more than an expediter. Rather, the broker is, if for no other reason than based on the license, an individual possessing a level of expertise as to real property practice not possessed by members of the public.

Real estate transactions have become relatively complex in recent years. As the needs and requirements of both sellers and buyers become increasingly specific and arcane, so do the knowledge and skill of the broker in satisfying these developing requirements. Real estate licensees are as much financial advisers, locators of funds available for lending, legal repositories, tax experts and property inspectors as they are marketing experts. Both sellers and buyers have come to depend upon the licensee for guidance and counsel in these and other areas to insure that their individual and common objectives are satisfied and that the always present risk of loss is minimized.

Have other approaches been attempted? Yes, they have, and generally these alternatives to the agency relationship have been found to be inadequate to meet these increasing needs

of the parties. For example, many books are generally available which purport to instruct prospective sellers and prospective buyers in accomplishing their transactional objectives without the assistance of the licensed real property expert.

Other entities have been created which perform in an employee (rather than in an agency) capacity. These businesses undertake only certain limited acts (such as furnishing advertising for the property, documentation for the parties). Other firms provide general advice to one party or the other, but participate no further in the negotiation process. Have these alternatives met with acceptance by the real property public? Generally, no. The public has substantially rejected these alternatives in favor of appointing an agent in whom it can place trust and confidence to protect and promote its interest. There continues to exist a recognition that an agent, as opposed to an employee, maintains an obligation beyond merely performing certain acts.

The agent involved in real property practice is perceived by the public and the law as a professional who holds himself/herself out as having special skills and knowledge of the subject matter of the transaction. Unsophisticated sellers and buyers of real property rely heavily on the expertise and counsel of real estate agents as to issues of value, price, general terms, financing, marketing, and the condition and habitability of the real property in question. When the agent undertakes to perform the above and other services he/she assumes an obligation to exercise greater skill and care than is required of an employee or than which members of the general public would be capable of providing for themselves.

The Agent as Fiduciary

The establishment of an agency relationship in California gives rise to a second legal relationship between the same parties. Under California law, upon being appointed an agent, by operation of law, one also becomes the **fiduciary** of the principal. The licensee thus occupies two separate and distinct offices vis a vis the principal's agent and fiduciary. The fiduciary relationship is separate and apart from the agency relationship, although the former is a result of the latter. A fiduciary relationship, as does that of agency, imposes on the individual so denominated an extraordinary standard of performance as well as specific duties owed by the fiduciary to the principal.

The agent deals with the property of the principal whether that property be real property, as in an agent/seller agency, or money in an agent/buyer relationship. The word fiduciary means trust or a thing held in trust. The principal places trust in the agent to protect and promote the interests of the principal. The agent is required keep the principal fully informed at all times during the period of agency and cannot reveal anything negative about his/her principal to a third party. Trustee/beneficiary is another example of a fiduciary relationship akin to agency.

Another aspect of this trust placed in the agent is that the thing itself, the subject matter of the agency, is entrusted to the agent. The agent is obligated to justify the trust that is bestowed on him/her. In order to ensure that this trust is justified, the law imposes severe liability on the agent who chooses to act in conflict to this concept of trust.

Duties Owed to Principal

The literature of law and of real property practice are replete with descriptions and explanations of the specific duties owed by the agent to the principal and, although often stated by the writers on the subject to be separate and distinct one from the other, the duties or obligations so considered are:

1. Duty of disclosure.
2. Duty of loyalty.
3. Duty to use skill, care and diligence.
4. Duty to account.
5. Duty to obey reasonable instructions.

Pursuant to the California Civil Code, an agent must specifically disclose to the principal all facts material to the transaction known by the agent, or which should be known by the agent. As to the measure of what is and what is not **material**, case law indicates that information is material if it would in any way affect a decision of the seller made during the course of the transaction. If the fact in question is likely to affect the judgment of the principal in assenting to a transaction, the fact is material and must be disclosed. In other words, any information which could result in a decision as to the sale, or which would in any way change the way in which the principal would negotiate the terms of the transaction, must be disclosed.

The reader should note, however, that the Attorney General for the State of California has specifically stated that while agents are obliged to fully disclose to a principal all material facts that might influence the decision concerning any real estate transaction, the race, creed or color of the other person is not a material fact and should not be disclosed, even though the information is at the request of the owner.

Not only is the agent under a duty to disclose information material to the transaction, the agent is obligated as well to explain to the principal, if the circumstances so dictate, the importance of the information and the effect that it may have upon the transaction. Under certain conditions, the broker may be under an obligation to make inquiry and investigate the existence of such material information. No longer will the agent be protected as to this duty by hiding behind the convenient veil of ignorance.

This obligation, which is sometimes referred to as the duty to give notice, is based to some extent on the fact that any knowledge obtained by the agent binds the principal. It is therefore critical that the principal share in whatever information is possessed by the agent. This obligation of disclosure has been substantially expanded during the past few years by both statutory and case law in California and it is suspected that this increasing concern with disclosure will continue into the foreseeable future.

“An agent must use ordinary diligence to keep his/her principal informed of his/her acts in the course of the agency.”

Stated in more common language, the agent has the duty to make a full and complete disclosure to his/her principal of all material facts which the agent knows or should know. The key word to understanding the full implications of this duty is the word material. What exactly constitutes a “material” fact which should be disclosed? The court in the case of Jorgensen vs. Beach N’ Bay Realty, Inc. (1981), held that if a fact is likely to affect the judgment of the principal in assenting to a transaction, the fact is material and must be disclosed. In simpler terms, any information which could result in a decision not to buy or sell, or which would change the way in which a principal would buy or sell, must be disclosed.

Duty of Loyalty

The duty of loyalty means that the agent is obligated to put the best interests of the principal before his/her own, as well as to treat as paramount the best advantage of the principal in relation to the interests of any third party. The agent is precluded from taking any action that would be adverse to the best interests of the principal. In that the agent, as far as the law is concerned, has “stepped into the shoes” of the principal. The former may not in any way conduct himself/herself or herself in such a manner as to jeopardize the position of the principal.

This duty of loyalty also requires that the agent not benefit from the relationship other than from the agreed upon compensation. Neither may the agent obtain any advantage over the principal by the slightest misrepresentation, concealment, duress, or adverse pressure of any kind.

If one accepts the definition of an agent as being a skillful, knowledgeable substitute or clone for a principal, then understanding this duty is simple. Would the principal generally always act solely for his/her own benefit? If so, then the agent as his/her substitute can do no less.

All too often the real estate licensee is admonished with the Golden Rule precept, “Do unto others as you would have them do unto you.” More appropriate to the agency relationship would be, “Do unto others as your principal would do unto others.”

Obviously, there are limits to this dictum. The agent does not have to defraud a third party just because his/her principal would, or because it is solely for the benefit of the principal. The dichotomy is not however so much to be found outside of the agency as it is within. (Particularly when one considers this duty to act solely for the benefit of the principal, in conjunction with the previously stated duty of disclosure.) The agent may, or often is, placed in the position of disclosing information which is adverse to his/her own interests in order to fulfill his/her duty to act solely for the benefit of the principal in an agency matter. To establish this point, a gross example will be used.

Illustration: “S” gives to “A,” his/her agent, a general power of attorney to sell his/her real property to anyone in the world for any amount of money.

Question: Who does “A” sell to, and for how much?

If “A” should sell the property to himself/herself for \$1.00 without the consent of “S,” the conveyance is effective at the election of “S.” Surely most agents would state that “A” breached

his/her fiduciary duty to “S” and should not be allowed to profit. The duty is to not only act solely for the benefit of the principal in matters entrusted to him/her, but also not to take unfair advantage of his/her principal in the use of information acquired by him/her because of his/her position as an agent. The cases dealing with **secret profits** and agents using a **strawman** to purchase the principal’s property are plentiful.

More mundane and yet more pervasive and to the point is the way in which real estate agents are customarily compensated, and whether it truly is in the best interests and solely for the benefit of the principal. Most agents would never secretly profit at the expense of their principal. Yet most agents would adamantly defend the customary compensation practices which occur in real estate brokerage. In the typical real estate transaction, the agent receives a commission based on a fixed percentage of the gross sales price. If the sale falls through, the agent gets nothing. The longer the property takes to sell, or the longer the transaction takes to close, the longer the agent must wait for the commission. It is understandably difficult for an agent not to urge and expedite the close of a sale.

How do conscientious agents justify this practice when it is so obviously in conflict and competition with acting solely for the benefit of the principal? Is not the present practice to get properties sold as quickly as possible? It can be rationalized that such are the seller’s objectives. Such rationalization, however, does not provide for the buyers objectives. Neither does it address the consequences of a transaction done in haste including potential costly rescission actions, suits for damages, etc.

If a law were passed today that all real estate agents were to be compensated on the basis of an hourly fee, say \$200 per hour, would the nature of the real estate transaction change? Would there be a more methodical and deliberate attempt on the part of real estate agents to ensure that all aspects of the transaction were in order and that truly the best interests of the principal were provided for? In defense of the real estate profession and not as a rationalization or justification, could not the same conflict of interest charges be leveled at the other professions as well? Don’t attorneys operate on contingent fees? What is the medical profession’s reputation regarding unnecessary operations? The question of how all professions are compensated remains unsettled and unsettling in our society. If rationalization or justifications is found by some to be necessary regarding the agent’s compensation, perhaps it is to be found in the fullest recital of this duty. In the Restatement (Second) of Agency (1958), Section 387:

“Unless otherwise agreed, an agent is subject to a duty to his/her principal to act solely for the benefit of the principal in all matters connected with his/her agency.”

The operative words to this dictum are, “unless otherwise agreed”. Obviously, most principals agree to the compensation agreement. The questions which must be posed are, is that agreement obtained because the principal has no alternative? The few attempts by scattered brokers to discount commission rates or to offer alternative compensation arrangements have been met with less than enthusiasm by the industry. The result of the industry’s reaction, evidenced by the United States Supreme Court Case, *McLain vs. Real Estate Board of New Orleans* (1980), dealing with price fixing and the California Appellate Court case, *People vs. National Association of REALTORS®* (1984) dealing with restraint of trade, may very well be just the beginning.

The principal who feels wronged will sooner or later find an attorney who will be willing to test, in court, the method by which real estate agents are compensated. Undoubtedly, the basis used will be the agent’s “duty to act solely for the benefit of the principal.”

Duty to Use Skill, Care and Diligence

An agent is required to exercise whatever degree of skill, care and diligence may be necessary to carry out the terms of the agency. This duty is sometimes described as the duty of competence. The measure of skill that must be exercised is measured, as is the general standard of an agent’s performance, against the theoretical “reasonably prudent agent acting” in the same circumstances. In addition to this requirement of ongoing care and diligence, it is well accepted in this state that should an agent attempt to perform as such and, for whatever reason, is not competent to carry out the terms of that transaction, the agent has violated his/her duties as a fiduciary.

The reader should be cognizant of the fact that for years various trade groups and individual brokers have labored mightily to increase the general standards of practice, seeking to bring to the industry a growing sense of professionalism. It should be evident, therefore, that what constitutes good practice will be a continually increasing standard for the foreseeable future. The courts in California, in fact, recognized the relationship between an agent’s competence and the principal’s motivation in retaining that agent’s services. “Agents are expected to make use of their superior knowledge and skills, which is the reason they are engaged.”

The case of *Chapple vs. Big Bear* (1980) is an excellent example of the relationship between an agent’s duty to exercise skill, care and diligence and his/her duty of disclosure. The court, in this case, held the agent was a fiduciary, with not only an obligation to disclose all material facts, but also the obligation to be certain that the principal understood the importance of the information. It is no longer sufficient for the agent alone to possess knowledge. It is also law that we must be diligent and ensure that our principals understand the ramifications of transactions. The days when the agent leads, and the principal meekly follows are gone forever. Obviously, if the agent does have the obligation to make certain that the principal understands the transaction, then it follows that the agent must have the necessary level of skill to understand it as well.

The unanswered question is “to what degree of competence will the agent be held?” With the introduction of the continuing education requirement, and increased educational requirements to qualify for broker and salesperson licenses, it can only be presumed that the standards by

which courts will measure the level of skill expected of a real estate agent will also rise. In addition to being required to possess technical knowledge about the nature and aspects of the transaction, the real estate agent is being held to a higher standard of professional care as to disclosures regarding the property as well.

In the case of **Easton vs. Strassburger (1984)**, the agent maintained that he “conformed to the highest standards of professional conduct then prevailing.” The court in finding him negligent for not disclosing soil problems in existence on the property, stated: *“Agents are expected to make use of their superior knowledge and skills, which are the reasons they are engaged. The jury was well within the bounds of reason when it concluded that a reasonably competent inspection of the property would have included something more than a casual visual inspection and a general inquiry of owners.”*

The general principles expounded in the “Easton” decision have been evident in many other court cases for years. As much as anything else, the significance of “Easton” is that it indicates the direction the public and the courts are headed. Prevailing standards of professional conduct and prevailing practices are not going to constitute a sufficient defense in legal actions. To avoid liability in future legal actions, agents are going to have to be able to evidence that they exceed prevailing standards. The prevailing standards of skill, care and diligence, at least in the eyes of the courts, leave much to be desired.

Duty to Account

An agent must, on demand, render an account to his/her principal. In fact, this obligation of providing an accounting compels an accounting by the agent to the principal even for funds received pursuant to the terms of an illegal contract, provided that payment to the principal will not aid in the commission of a criminal act. This duty ensures that any money or other property received by the agent on behalf of the principal is not the agent’s and he or she must, except under special circumstances, surrender it to the principal on demand. Additionally, an agent must maintain adequate and appropriate records concerning the property involved in the particular transaction.

The problem agents confront most often within the context of this duty, in the typical transaction, is what to do with deposit money. If the deposit is in the form of a promissory note, the agent has the simple duty of informing the principal of this fact prior to the principal’s consideration of an offer. This is but a small dilemma. The following illustration indicates the kind of dilemma an agent can face.

Illustration: “P” enters into a conditional sales purchase contract with “S.” “P” gives “A” \$10,000 as a deposit. “A” deposits the money in her trust account. Subsequently, “P” states that the condition cannot be fulfilled and demands the deposit be returned. “A” asks “S” for consent to return the deposit and “S” refuses and demands the deposit be turned over to him/her.

Questions:

1. What does “A” do with the money?
2. Who owns the deposit money?
3. Would it make any difference if the money was in a title insurance company or escrow company trust account?

The answer to the above questions hinges on who has title to the money and at what specific time did title change.

If there is any question whatsoever in the mind of an agent and he/she cannot obtain an agreement between the parties as to whom a deposit belongs, the best practice would be to hold the deposit. By doing so, the agent must recognize that he/she risks breaching this fiduciary duty to account to the principal. Another solution to such a problem would be to initiate an **interpleader action** and have a court determine the disposition of the deposit money.

Duty to Obey Reasonable Instructions

Provided that the instructions of the principal to the agent are relevant to the transaction for which the agent was retained and provided those instructions are reasonable and non discriminatory, the agent has an obligation to obey those instructions. This duty has been interpreted to include the duty of the agent to in no way exceed the authority granted by the principal. It is also interpreted as the right of a principal to control the duties of an agent. When an agent acts without the authority or in excess of his/her authority, he/she may be held liable for damages suffered by the principal.

Other General Duties

In addition to these specific duties owed the principal by the agent, the agent is liable to the principal for any act or conduct for which he/she would be held responsible if involved in most other relationships. Thus, under certain circumstances, an agent will be held liable for breach of contract, tort, or other civil wrongdoing.

Duties of a Fiduciary

Specific fiduciary duties are often described as trust, confidence and competence. For there to be a fiduciary relationship the principal must have a reasonable expectation that the agent will carry out the task subject to the agency (trust) and that any information given the agent by the principal, whether that principal be seller, buyer or both which, if disclosed, would work to the disadvantage of the principal, must be kept confidential (in confidence) by the fiduciary agent. The agent must act throughout the transaction in a competent and professional manner.

Duties Owed by Agent to Third Parties

The duties owed by the agent to the party opposite the principal (in the real property context, usually the buyer) are restricted to honest and fair dealing.

Honesty and Fair Dealing

Obviously, this obligation owed to third parties does not begin to approach the extent and significance of the fiduciary duties owed by the agent to the principal. Generally, the agent has the same liability to the third party as does the principal. The principal cannot, for example, commit fraud against a party to a transaction. Similarly, neither can the principal's agent. In the typical real estate transaction, both the seller and the agent have an obligation to disclose to the purchaser facts materially affecting the value and desirability of the property that are

not known to, or within the reach of, the diligent attention and observation of the purchaser. Due to the “substitute” status of the agency relationship, if no disclosure of the material defect is made by anyone, both the principal and agent may become jointly and severally liable.

It can be said, therefore, based on the concept of vicarious liability, that the duty owed by the agent of fair dealing and honesty with the third party is one, while involving the party opposite the principal, is a duty owed to and for the benefit of the principal.

Duty to Warrant Authority

Included within this duty attaching to the agent of honesty and fair dealing as to third parties is the agent’s duty of warranty of authority. As will be discussed below, the limits of the agents conduct are defined by the authority conferred upon the agent by the principal. Should the conduct of the agent exceed the authority bestowed, and should the third party be damaged by this conduct, the agent will be held responsible to that individual. In addition, like the principal, the agent may be held liable for acts for which liability would attach in any other relationships: breach of contract, tort, fraud, and other civil wrongs.

Aside from this traditional approach to the agent’s duties to the third party, statutory law in California likewise imposes additional duties on the agent in this regard. For example, Article “I” of the California Civil Code imposes upon the agent/broker the duty to perform a reasonably competent visual inspection of listed residential property and to disclose to all prospective buyers any material information regarding that property obtained as a result of that inspection. This duty requires an inspection of all reasonably accessible areas. By this same article, the buyer is also held to a duty to take whatever care is reasonably necessary to protect his/her own interests in these matters.

Civil Code Provisions

Article 2. Duty to Prospective Purchaser of Residential Property.

It is the duty of a real estate broker to a prospective purchaser of residential real property comprising one-to-four dwelling units, including a manufactured home (mobilehome), to conduct a reasonable competent and diligent visual inspection in accessible areas of the property offered for sale and to disclose to that prospective purchaser, on an approved disclosure form, all facts material affecting the value or desirability the property that such an investigation would reveal. This becomes an obligation if the broker has a written contract with the seller to find or obtain a buyer, or is a broker who cooperates with such a broker to find and obtain a buyer.

The provisions of this article relating to sale transactions of residential real property comprising one-to-four dwelling units apply with equal force to leases of that property that include an option to purchase, ground leases of land on which one-to-four dwelling units have been constructed, or real property sales contracts, as defined in Section 2985 (this code) for that property.

The standard of care owed by a broker under this article is the degree of care that a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience, and examination, required to obtain a license under the provisions of the Business and Professions Code.

The inspection to be performed pursuant to this article does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection and, if the property comprises a unit in a planned development as defined in the Business and Professions Code, a condominium as defined in this code or a stock cooperative as defined in the Business and Professions Code, does not include an inspection of more than the unit offered for sale, if the seller or the broker complies with the provisions of the Civil Code.

In no event shall the time for commencement of legal action for breach of duty imposed by this article exceed two years from the date of possession, which means the date of recordation, the date of close of escrow, or the date of occupancy, whichever is first.

Nothing in this article relieves a buyer or prospective buyer of the duty to exercise reasonable care to protect himself/herself, including those facts which are known to or within the diligent attention and observation of the buyer or prospective buyer.

Disclosure Format

The Civil Code establishes that any transfer by sale, exchange, installment land sales contract, lease with an option to purchase, any other option to purchase, or ground lease coupled with improvements, of real property, or residential stock cooperative, improved with or consisting of not less than one nor more than four dwelling units, requires that a disclosure must be made to the transferee prior to the transfer of the property.

This disclosure must be in written form and must be made by the seller, by the seller's agent and by the buyer's agent, if agents are involved in the transaction.

It is the intent of the legislature that the delivery of a real estate transfer disclosure statement may not be waived in an "as is" sale.

The following requirements now apply:

1. This disclosure must be presented in a format specified by statute.
2. The disclosure must be made by delivery to the buyer either (in the circumstances of a sale) as soon as practicable before the transfer of title takes place, or (in the case of a lease with an option to purchase, ground lease coupled with improvements, other option to purchase, or land contract) prior to the execution of the contract; and
3. If the prescribed disclosure is delivered after the execution of the offer to purchase, a recessionary period, as to the offer, is created. In this event, the buyer, if delivery is made in person, has three days from the date of the delivery and in the event delivery is made by mail, then the buyer has five days from the date of the deposit into the mail, to rescind (terminate) his/her offer to purchase by written notice to the seller.

Under the provisions of the most recent changes in the law, the duty of disclosure is charged to the seller, the seller's broker, and even to the buyer's broker, if one is involved in the transaction. If more than one broker is involved in the transfer of the property, the delivery of the disclosures to the buyer (transferee) would ordinarily be the responsibility of the broker who obtained the offer made by the transferee. The seller may also give other written instructions for such delivery.

If, on the other hand, the broker responsible for the delivery of the disclosures cannot obtain the documents required, or if the seller has instructed the broker to keep information required to be disclosed confidential, or if the broker has no written assurance that the transferee has received such disclosures, then, that broker must advise the purchaser in writing of his/her rights to such disclosures. The broker with this responsibility must maintain a written record of the action he/she has taken in this matter as required by Real Estate Law.

Should any person or persons involved in such a transfer of property fail to comply with this disclosure requirement, whether willfully or through negligence, the transfer itself will not be invalidated solely because of the failure to comply. The person or persons responsible for the failure to comply will be liable for the payment of the actual damages suffered by the transferee because of the failure to meet the requirements of this law.

Disclosure of Agency Representation

A license is required, to disclose the licensee's understanding as to whom his/her representation as agent extends. This must be accomplished in a format prescribed by the law as soon as possible.

The Civil Code requires all licensees to sign a statement setting out the agency relationship involved. The purpose of the statute is to inform the parties involved, usually the buyer and the seller, which licensee represents their interests as their agent in the transaction at hand.

The disclosure statement not only sets out the specific relationships between the parties but also, perhaps more significantly, explains the duties and legal obligations owed by the licensees to the buyer and seller respectively.

The Civil Code applies to the brokering of all residential properties of from one-to-four units, whether for sale or for lease for a period exceeding one year.

Misrepresentation

As with any area of activity involving sales, real property brokering is susceptible to unscrupulous practitioners who, without intent, misrepresent the qualities of a particular property.

In California, acts of **misrepresentation** are categorized. Keep in mind that not all misrepresentations are necessarily intentional nor necessarily fraudulent. Misrepresentation generally falls into one of these categories:

Puffing - An intentional misrepresentation of fact that would, by a reasonably prudent person, be perceived as an exaggerated statement not to be taken literally. An example: A broker shows a prospective buyer a listed property. After the tour, while standing out in the front yard of the property, the potential buyer tells the broker: "This is a very nice neighborhood," to which the broker responds, "This is the nicest neighborhood in California." The broker's statement is a misrepresentation of fact. However, the statement is not (hopefully) one meant to be taken literally; rather, it is part of the broker's sales pitch. Comparing the broker's statement to the definition of fraud, there is no intent to deceive. In other words, a reasonably prudent person would understand this representation as an "innocent exaggeration". Puffing is not fraud. Obviously, the problem with puffing is as to where the puffing ends and fraud begins.

Mistake - A valid contract implies a mutual agreement of the parties. When there is a substantial mistake as to a material fact which caused the complaining party to enter into the agreement, the contract may be void or voidable. The fact that the injured party was negligent does not in itself preclude release from mistakes, unless this negligence is gross, such as the failure of the injured party to read the agreement. If the negligence is on the part of the agent the injured party may have a right to rescind the agreement. A person who accepts or signs an instrument, generally is deemed to have accepted it and agreed to the terms stated in it. Thus, in the absence of fraud, duress or undue influence, the person signing the document later cannot escape liability from its provisions on the grounds of not having read it.

Negligent Fraud - When an agent makes a positive statement of fact about which he/she does not have sufficient information to justify such an assertion, the agent's good faith is no defense to a charge of fraud. In other words fraud does not necessarily imply that the person charged with its commission acted with a malicious intent to defraud others and cause them damage. Persons may act "fraudulently" because they were careless or negligent in their words or acts. Negligent fraud subjects a licensee to disciplinary action, civil action, and possibly criminal action.

Known False Statement - If an individual does make a statement, intentionally, with knowledge of its inaccuracy or makes the statement having cause to doubt its accuracy, then the statement is fraud.

Failure to Disclose - The failure to disclose a fact material to the transaction whether to buyer or seller, is fraud in California.

If the seller makes a known false statement that is relied upon by both the broker and the buyer and as a consequence of that lie, the transaction falls out of escrow and the buyer sues the seller and broker, the seller would be responsible for both the commission plus damages for defending against buyer's suit.

Alquist-Priolo Special Studies Act

The **Alquist Priolo Special Studies Act** regulates development in earthquake fault areas in California. It is concerned with fault ruptures, not shaking damage. The law requires the State Geologist to establish Earthquake Fault Zones of active faults and to issue appropriate maps. Local agencies must regulate most development projects within the zones. Projects include all land divisions and most structures for human occupancy. Single family wood-frame and steel-frame dwellings up to two stories not part of a development of four units or more are exempt. However, local agencies can be more restrictive than state law requires. This information must be disclosed to the buyer.

When Fiduciary Duties are Not Owed

Generally, when an obligation is created by contract, it can be relinquished by contract. It is possible given certain circumstances a licensee may act in a transaction for which a license is required without the imposition of the duties discussed above. Within limits, the party in whose favor these duties run, can waive this protection.

Middleman

This can be done in one of two ways. If the licensee is acting as a true **middleman** or finder, and if this status (versus that of an agent) is clear and unambiguous, and if all parties to the transaction agree to and acquiesce to this status, and without some inequity being suffered by the party, normally the principal, it is possible that the courts will afford recognition to this arrangement. In this case, the duties of an agent (and therefore the duties of a fiduciary) do not attach because, in fact, no such relationship exists.

The courts in California have defined a middleman as one with limited authority, having no power to negotiate the terms on which the principals will deal, and where the authority is so limited that there is no opportunity for that individual to sacrifice the interests of one principal to the detriment of the other. A broker relying on his/her middleman status for protection from liability as an agent would be well advised that any activity, however slight, beyond arranging an introduction between parties, will result in the broker being found to be an agent. The attitude of the courts as to this issue is well reflected in a quote from *Hale v. Wolfsen* (1969) Cal App 2d, 285, a leading case on this question in California:

“Whenever the acts or omissions of a (licensee) cause injury
in a real estate transaction, there is a
compelling reason to find him/her an agent.”

Waiver

It may be possible as well that a principal will be allowed to waive the protection afforded by the law, even if the relationship satisfies the definition of agency. This waiver, if to be made effective, must be in writing and must be intelligently made by the principal. It is suggested that if this waiver be the intent of the parties, the specifics of the circumstances resulting in this waiver should be explained in the writing by recital.

Any party contemplating such a waiver should be aware, however, that there exists a public policy in this state disfavoring this type of waiver. Such a waiver will likely be found unenforceable if the result of the waiver would be unfair as to the principal, or if the waiver was entered into by the principal lacking an understanding of the consequences of that action.

Dual Agency

Dual Agency is the concept that holds that under certain circumstances, an individual can act as the agent for both parties to a transaction. In the context of real property practice, this would involve a licensee acting as the agent for both the buyer and the seller. If dual agency does not exist then the duty of the agent and the compensation paid to the agent are of consequence only between the agent and the single principal involved.

An exchange agreement usually creates a dual agency. This contract form involves two principals in trading real properties. In the terms of the standard form in use both parties agree to pay compensation to the licensee named for services rendered.

Consent Required

Regarding dual agency, California law provides that under no circumstances may a licensee act as a dual agent without the knowledge and consent of all parties to the transaction. No matter the degree of honesty displayed by the agent in the transaction, without this consent, the licensee will be allowed to recover compensation from neither seller nor buyer. Further, by case law, an undisclosed dual agency provides the ground for rescission by either party without having to make a showing of financial loss or other damage.

Aside from the more important, logical problems with the concept of dual agency, its use expands significantly the licensee's liability arising from a real estate transaction. The relationship of agency imposes upon the broker extraordinary obligations and duties to the principal. As a result of these duties, the agent is financially liable to the principal should the latter suffer any financial loss resulting from the licensee's failure to comply. Duties create liabilities. Therefore, if these duties are owed by the agent to two parties instead of just one, the agent's liability has been expanded one hundred percent and failure to comply because of the necessity of having to satisfy those obligations as to competing or adverse parties is made more likely.

As perhaps some indication of the problems associated with dual agency, current law in California requires that all licensees must disclose in writing to the sellers or buyers that they represent that they are acting as agents.

The Gratuitous Agent

Consideration is not required for the relationship. An agent who works without compensation is called a **gratuitous agent**.

While an agent cannot be compelled to enter into a transaction with no promise of compensation, once an agent does agree to undertake a particular representation, whether for pay or not, the agent is then bound to perform whatever it is that he/she promised to do. The agent considering the acceptance of a project without compensation, or considering a project at a discounted fee, should keep in mind that the lack of compensation, or discounted compensation, has no effect whatsoever on the duties owed by the agent to the parties to the transaction. The liability of the agent remains the same regardless of the amount of compensation received.

Duties of the Gratuitous Agent

Consideration is not necessary to create an agency.

By law, a commission is usually negotiated between the principal and the broker prior and is included in the written listing form. If an agent is not being compensated for performing acts as an agent, such agent is referred to as a gratuitous agent, as was indicated before. The fiduciary duties of gratuitous and compensated agents have been held to be the same by courts. In the case of *Renaissance Realty, Inc. vs. Soriano* (1981), the buyer orally requested the

broker to negotiate for the purchase of a specific home for the buyer. The broker contacted the owner. A sales agreement was entered into. The seller agreed to pay the broker a commission. The broker did not disclose this fact to the buyer. The court held that by failing to disclose the commission agreement, the broker had breached his/her fiduciary duty to the buyer. Obviously, in this transaction the broker was found to be the agent of the buyer even though the compensation was paid by the seller.

The legal ability to create agency by other than contractual agreement is a double-edged sword for the licensee. This is so because real estate law provides that the broker can enforce any agreement with the principal regarding compensation only if the agent's claim is based upon a written instrument. In the case of an agency by ratification or by ostensible authority, the duties of agency and of a fiduciary attach to the licensee along with the associated liability. The agent will very likely be unable to enforce any agreement regarding commission or other compensation against the principal.

Creation of the Agency Relationship

An agency may be created by one of three methods:

1. By express agreement.
2. By ratification.
3. By conduct and estoppel; ostensible agency.

Express Contract

In real property practice, the agency relationship is normally established by the execution of an express agreement between the seller and broker. This contract is commonly referred to as a "listing agreement" or "authorization to sell." The listing agreement is a contract governed by general contract law. The Statute of Frauds requires that all agency contracts, such as a listing agreement, be based upon a written agreement. The agency created in this manner is referred to as an **actual agency**.

As can be said about any contract, a listing agreement is a series of promises between two or more individuals that can be judicially enforced. When the seller signs the listing agreement, the seller is making two principle promises to the broker: (1) that the broker is authorized to act on behalf of the seller in attempting to locate an able and willing buyer for the subject property, and (2) that should the broker be successful in locating such a purchaser the seller will pay to the broker an agreed upon compensation, usually a commission based upon the actual selling price. The broker makes one primary promise when signing the listing agreement, this promise being that the broker will use his/her best efforts in attempting to locate the able and willing buyer.

The most important thing that occurs when the listing agreement is signed, in terms of legal consequences, is the written appointment of the broker as agent by the seller. From the time that the broker is authorized to act as the seller's agent, the specific duties discussed above attach to the broker in his/her relationship to the seller.

Ratification

It is also possible to create an agency relationship by what is called ratification. In the absence of circumstances requiring an authorization in writing, if one individual holds himself/herself out as being another's agent and in so acting bestows upon that individual some benefit which is accepted by the latter, such an acceptance will generally prompt the courts in California to recognize the relationship between the two as being one of agency. This is often how a real estate broker becomes the agent of a buyer. For example, the agent is showing a buyer property that is listed through the multiple listing board. The buyer asks about a property on a corner that is not listed for sale. The broker asks the buyer if he/she would like to make an offer on the unlisted property. If the broker accepts a check from the buyer, the broker becomes the agent of the buyer. This creates a fiduciary relationship with the buyer.

Note that any third-party dealing with the purported agent will not in any way become bound until the conduct in question is ratified. This relationship is not revocable under this rule if the agent, separate and apart from the status of agent, maintains an interest in the subject matter of the transaction. In that case, the relationship is often characterized as an "agency coupled with an interest."

Ostensible Agency

A third method by which the agency relationship can be created is based on the theory of estoppel. That is, if an owner through his/her conduct, or by want of ordinary care, leads a third party to believe that a broker is, in fact, authorized to act as that owner's agent, and if that third party does indeed rely on that representation, the purported principal will be stopped from denying that agency. Note here that **ostensible agency** cannot be created solely by the conduct of the agent. The most important consideration in the concept of ostensible agency is the conduct of the principal.

Actual and Ostensible Agencies

There is no specific or formal procedure provided for in law which must be complied with in order to establish an agency, such as entering into a listing agreement. Much of the confusion of real estate buyers, sellers, and real estate licensees is due to the ambiguity surrounding when the agency relationship is established and how. Many real estate licensees still cling to the belief that only through the listing agreement is agency established in real estate transactions. The California Civil Code provides that: "An agency may be created and an authority may be conferred by a precedent authorization or a subsequent ratification."

In other words, a principal may appoint an agent prior to an agency action by conferring authority on the agent to act for the principal. Such an authority would be, for example, a listing agreement. Just as viable in terms of creating an agency, however, would be a verbal authorization such as "Would you take care of opening an escrow for me?" If the licensee does open the escrow, he/she is becoming an agent for purpose of performing the act.

While less definite and precise, an agency established by "subsequent ratification" is no less an agency. For example if a principal did not instruct a licensee to open an escrow and the real estate licensee opened the escrow on his/her own authority, then upon ratification (approval) of the act by the principal, the agency would be established retroactive to when the act

was performed. One of the major reasons real estate licensees are being “surprised” in legal actions today is because they fail to understand that an agency can be created by subsequent ratification. The licensee goes in front of the judge and states, “But your honor, I was not the agent of the person.” When the opposing party takes the stand, all they have to say is, “Your honor, I hereby ratify all acts performed by the licensee as my agent.”

Now we can analyze to see if he/she breached any of his/her fiduciary duties in performing these acts. An agency, in that set of circumstances, was created by subsequent ratification. While no special or formal procedures are required in order to establish an agency, the question the courts will ask is “What was the intent of the real estate licensee?” and “What was the intent on the part of the member of the public?” Given a dispute as to intent, the licensee denying intent and the public’s assertion as to the intent, the courts will most commonly weigh evidence heavily in favor of the public. The evidence the court will seek out will be, “Did an agreement exist?” or, if no agreement can be found to exist, “What were the surrounding facts and circumstances?” If the court finds that an agreement exists, it will describe the agency as an “actual” agency. The definition of an actual agency is found in the Civil Code and is described as follows:

“An agency is actual when the agent is really employed by the principal.”

In other words, actual agency exists when there is a definite relationship established which is acknowledged between the parties. Acts such as entering into a listing agreement, or a purchaser verbally authorizing a broker to locate a property for the purchaser, are examples of actual agency.

The Civil Code also provides for what is called ostensible agency. This type of agency is dictated by the surrounding facts and circumstances, rather than by the acknowledgment of the parties. The Civil Code describes an ostensible agency as follows:

**“An agency is ostensible when the principal intentionally, or by want
of ordinary care, causes a third person to believe another
to be his/her agent.”**

An ostensible agency can be implied on the basis of the acts of the parties. This conclusion was supported in the case of Pollack v. Lytle (1981). In order to clarify how ostensible agency can be established, the following two examples are provided:

Illustration: “A,” “S,” and “P” are all standing in close proximity. “A” says to “S,” “I’m your agent.” “S” does not say or do anything. As to “P,” “A” has become the ostensible agent of “S.”

In the above illustration, there can be no doubt that an ostensible agency was formed. The surrounding facts and circumstances are almost a recitation of the Civil Code. In real life, the surrounding facts and circumstances are generally never that clearly set forth. Also, in real life the Code must be interpreted by a human being, the judge. Given the circumstances within which we must exist, let us examine an illustration which more closely reflects real life.

Illustration: “A” and “P” are standing in close proximity. “P” says to “A,” “You are my agent.” “A” does not say or do anything at that point in time but subsequently performs acts that could be construed as representing a broker.

Questions:

1. Has “A” become the ostensible agent of “P”?
2. If “A” claims he/she did not hear “P” state “You are my agent,” will it make any difference?

In some circumstances, an agency relationship may be created to the “surprise” of the agent. The law will be quick to find the existence of an agency relationship between a real estate licensee and a member of the public, particularly when it becomes necessary in the mind of the judge, to protect the public interest. Where there is doubt as to whether an agency relationship existed, or did not exist, the burden of proof will be on the agent.

Judicious licensees, therefore, will strive to see that written agreements exist, establishing the existence or nonexistence of the relationship which they are seeking to affirm or deny.

Summary of Facts Involving Agency

1. A listing always creates a fiduciary relationship.
2. The fiduciary relationship created by a listing is similar to a trustee relationship.
3. Under a listing agreement with the seller, the broker owes his/her fiduciary obligation to the seller only.
4. Though his/her fiduciary obligation is to the seller, the licensee still has an obligation of honesty and fairness to the buyer.
5. The laws of agency are concerned with three relationships:
 - (a) Agent to principal (fiduciary)
 - (b) Agent to 3rd party (honesty, fairness)
 - (c) Principal to 3rd party (seller responsible for agent’s actions)
6. Consideration is not required for a valid agency. An agent working without compensation is termed a “gratuitous agent.”
7. Generally, an agency relationship can be revoked by either party (with possible liability for breach).

8. When an agency is coupled with an interest, it is irrevocable.
9. An agent must present all offers. When an agent receives more than one offer, he/she must present all offers at the same time and without instructions to the contrary, all offers must be presented.
10. If an agent discovers termites in a structure, he/she must inform seller and buyer.

Termination of the Agency Relationship

The relationship of principal and agent may be terminated in five ways:

1. Agreement.
2. Revocation.
3. Death or incompetency.
4. Expiration.
5. Extinction of the subject matter of the listing.

As with most relationships created by contract (as well as by ratification and by estoppel), the agency relationship can be terminated upon the agreement of the parties. In addition, under California law, the principal, because of the unique character of the agency relationship, is given the power to unilaterally revoke the agency at any time. However, the principal, while having the power to so revoke but not necessarily the right may, under proper circumstances, be liable to the agent as the result of the breach of the contract. Another method by which agency contracts may be terminated is based upon the characterization of the contract itself.

Agency contracts, such as listing agreements, fall into a category of contracts called “personal service contracts.” Personal service contracts such as listing agreements, automatically terminate on the death or incompetency of either party.

The agency relationship may also be terminated according to its own terms. That is, if the listing agreement, by its terms and conditions, is to terminate upon the agreed date, then the relationship established by that contract will, in fact, so terminate at that point in time. This type of contract termination is generally referred to as “expiration.”

Finally, the agency relationship between the agent and principal will terminate should the subject matter of the contract in this context the real property be, for whatever reason, incapable of being sold. For example, if the house of the listing is destroyed it will result in a termination of the agency relationship. Termination of a contract on this basis is said to be by reason of the “extinction of its subject matter.”

Subagents

Note that during our discussion regarding agency and in referring to real property licensees, the word broker rather than sales licensee has, by intention, been used. In California only a broker can be a party to a listing agreement. Usually, the terms of the listing agreement will permit the broker to utilize the service of others, such as sales licensees and cooperating brokers, to carry out the purpose of the agency. In this circumstance, with the sales licensee

working the listing entered into by the broker with the principal, the broker remains the agent. The sales licensees are the agents of the broker, and, as such, owe the same duties to the principal as does the broker they represent.

Disclosure Requirements

California law requires persons acting as listing agents and selling agents to provide sellers and buyers with prescribed disclosure forms containing general information regarding the agency relationships which exist in certain residential property transactions. These requirements must be met in transactions involving the sale and/or the exchange of certain estates of inheritance or perpetual estates, life estates and leaseholds exceeding one year's duration in residential real property improved with one-to-four dwelling units or involving the sale or the exchange of mobilehomes through a real estate licensee.

This law calls for contracts in these transactions to specify:

- Whether the listing agent represents the seller exclusively or both the buyer and the seller, or
- Whether the selling agent represents the buyer exclusively, the seller exclusively or both the buyer and the seller.

Agency Not Based on Compensation

In addition, the statutes determine that in the transactions to which it applies, neither the payment of compensation nor the obligation of a buyer or a seller to pay compensation to a real estate agent is necessary to create an agency relationship.

Associate Licensees

The law further provides that associate real estate licensees are agents of the real estate broker and when an associate real estate licensee owes a duty to any principal or to any buyer or seller who is not a principal, that duty is equivalent to the duty owed to that party by the broker for whom the associate licensee functions.

Restrictions for the Dual Agent

This law also expressly forbids a dual agent from disclosing specified price information to the other party to the transaction without consent, but this would not affect existing law as to the disclosure of other confidential information. The law establishes that a listing agent is not a dual agent solely by reason of being the selling agent and it precludes a listing agent from acting as the agent for the buyer only. The law further permits real estate brokers to execute forms of agency relationships which are neither described nor prohibited by this law if certain disclosures are made.

Finally, the law does not diminish any duty of disclosure owed by real estate agents and their subagents, associate licensees, and employees to buyers and sellers nor does it relieve them of liability for conduct in connection with acts subject to this law or breaches of fiduciary duty or of any duty of disclosure.

Here are some appropriate definitions of terms used frequently in the subject matter in this portion of the text:

Agent - A person acting in a real property transaction who is licensed as a real estate broker and under whose license a listing is executed or an offer to purchase is obtained.

Listing Agent - A person who has obtained a listing of real property to act as an agent for compensation.

Selling Agent - A listing agent who acts alone, or an agent who acts in cooperation with a listing agent, and who sells or finds and obtains a buyer, or who finds a buyer for a property for which no listing exists and presents an offer to purchase to the seller.

Subagent - A person to whom an agent delegates agency powers as provided by law. However, subagent does not include an associate licensee who is acting under the supervision of an agent in a real property transaction.

Disclosure of Physical Conditions

There is still another area in which real estate licensees have been required to make certain disclosures to the parties with whom they deal in certain real estate transactions. This legislation requires that specified written disclosures regarding the physical condition of the property be made to prospective transferees of:

- Real property improved with one-to-four dwelling units in a sales transaction.
- A lease with an option to purchase.
- A ground lease coupled with improvements.

These disclosures would cover such items as appliances, structural defects and modifications, possible easements, flooding drainage, soil problems, and weather conditions. They also would specify whether structural modifications and other repairs or alterations comply with the applicable building codes.

Effective June 1, 1998, a Natural Hazards Disclosure Statement must be used in certain transfers of real property improved with one-to-four dwelling units. Affected properties and transfers are those for which a Real Estate Transfer Disclosure Statement (TDS) are required and the property is in one or more of the natural hazard areas described below.

1. Special flood hazard area.
2. An inundation area which will flood if a dam fails.
3. A very high fire hazard severity zone.
4. A wildland area that may contain substantial forest fire risks and hazards.
5. An earthquake fault zone. These zones are over earthquake faults and are usually about one quarter mile in width.
6. A seismic hazard zone. In an earthquake, properties in one of these zones may be subject to strong ground shaking, soil liquefaction, or landslide.

The seller's agent must make a disclosure if the seller, or the seller's agent, has actual knowledge of any of these six items; or the local jurisdiction has compiled a list of parcels

that are in the area and has posted at the offices of the county recorder, county assessor, and county planning agency a notice regarding the availability of the list.

Seller Responsibility

The obligation to make the required disclosures to the transferee would generally be the responsibility of the transferor or the transferor's agent. If more than one real estate broker acts in the transaction, the broker obtaining the prospective transferee's offer would be required to deliver the written disclosures to the transferee unless the transferor gives other written instructions for the delivery.

Broker Responsibility

The law also allows that if the responsible broker cannot obtain the required disclosures and they are not otherwise delivered or waived, the broker would be required to advise the prospective transferee of his/her rights under this law.

Transferors and/or their agents are required to make a record of compliance with this disclosure requirements. Should any violation of this statute take place, it would not invalidate the transfer but any violator would be liable to the transferee for actual damages suffered by the transferee. The transferor or his/her agent would not be liable for errors, inaccuracies, or omissions in the disclosure required by this law if they were unknown to the persons involved.

These statutes do not ordinarily apply to an escrow agent performing escrow services as an agent for the transferor and/or transferee unless there is an express written agreement to the contrary. The terms of the contract would determine the responsibility which might exist.

The disclosures called for by this legislation are to be made in good faith, which is interpreted to mean honesty in fact in the conduct of the transaction.

Such disclosures do not limit or modify any obligation for disclosure created by any other provisions of other law or what exists to avoid fraud, misrepresentation, or deceit in the transfer transaction.

The delivery should personally be made to the transferee (buyer) or by mail. Delivery to the spouse of the transferee will be interpreted as delivery to the transferee unless the contract provides otherwise.

notes:

Chapter 2 Summary

With the establishment of an agency relationship the agent becomes the **fiduciary of the principal**. The word fiduciary means trust or a thing held in trust. The agent is required keep the principal fully informed at all times during the period of agency and cannot reveal anything negative about his/her principal to a third party. Trustee/beneficiary is another example of a fiduciary relationship akin to agency. An agent owes all others the duty of fair and honest dealing.

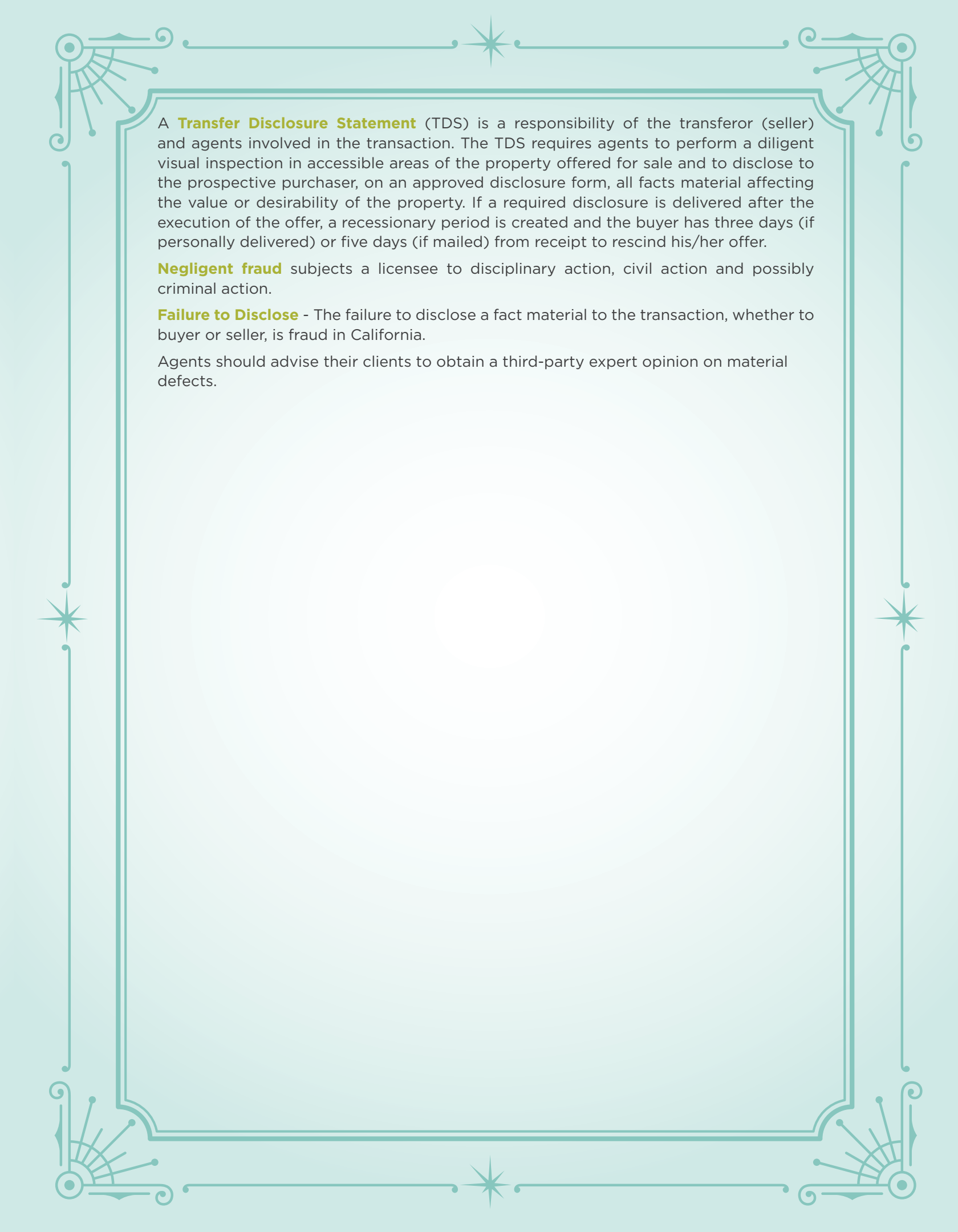
Agency relationship is normally established by the execution of a written agreement between the seller and broker, typically a listing agreement which establishes an **actual agency**. Agency relationships can also be established by an agent's actions, **ratification**, and by actions that cause a third party to rely on an agent called **ostensible** agency.

Summary of Facts Involving Agency:

1. A listing always creates a fiduciary relationship.
2. The fiduciary relationship created by a listing is similar to a trustee relationship.
3. Under a listing agreement with the seller, the broker owes his/her fiduciary obligation to the seller only.
4. Though his/her fiduciary obligation is to the seller, the licensee still has an obligation of honesty and fairness to the buyer.
5. The laws of agency are concerned with three relationships:
 - (a) Agent to principal (fiduciary)
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 - (c) Principal to 3rd party - (seller responsible for agent's actions)
6. Consideration is not required for a valid agency. An agent working without compensation is termed a "gratuitous agent."
7. Generally, an agency relationship can be revoked by either party (with possible liability for breach).
8. When an agency is coupled with an interest, it is irrevocable.
9. An agent must present all offers. When an agent receives more than one offer, he/she must present all offers at the same time, without instructions to the contrary.
10. If an agent discovers termites in a structure, he/she must inform seller and buyer.

The relationship of principal and agent may be terminated in five ways:

1. Agreement.
2. Revocation.
3. Death or incompetency.
4. Expiration.
5. Extinction of the subject matter of the listing.



A **Transfer Disclosure Statement** (TDS) is a responsibility of the transferor (seller) and agents involved in the transaction. The TDS requires agents to perform a diligent visual inspection in accessible areas of the property offered for sale and to disclose to the prospective purchaser, on an approved disclosure form, all facts material affecting the value or desirability of the property. If a required disclosure is delivered after the execution of the offer, a recessionary period is created and the buyer has three days (if personally delivered) or five days (if mailed) from receipt to rescind his/her offer.

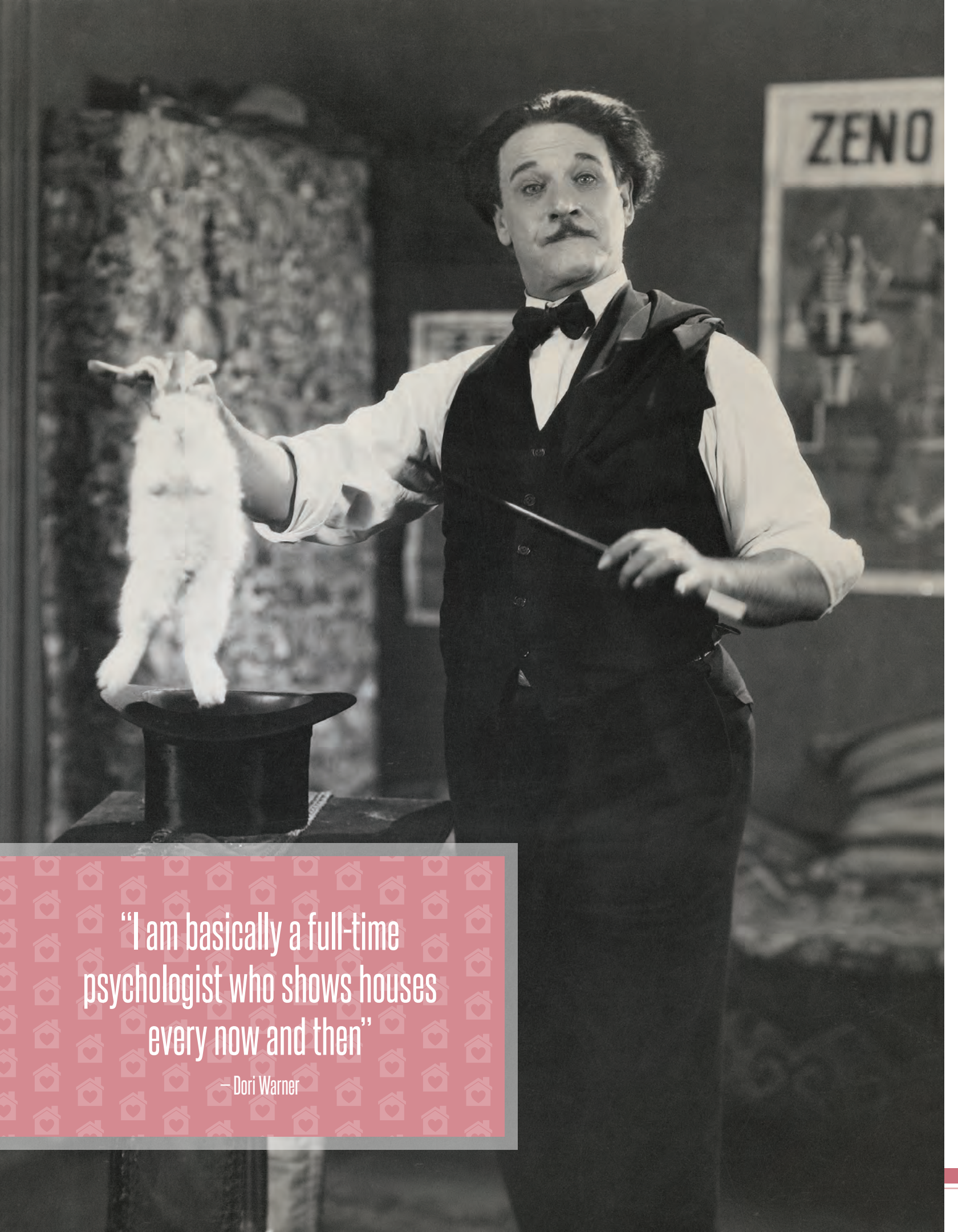
Negligent fraud subjects a licensee to disciplinary action, civil action and possibly criminal action.

Failure to Disclose - The failure to disclose a fact material to the transaction, whether to buyer or seller, is fraud in California.

Agents should advise their clients to obtain a third-party expert opinion on material defects.

chapter 2 quiz

- 1. A real estate licensee who misrepresents a property to a buyer while acting as agent for a seller may subject himself/herself to:**
 - a. Disciplinary action by the licensing authority.
 - b. Civil action.
 - c. Criminal action.
 - d. All of the above.
- 2. If the broker is the agent of the seller, he/she owes the buyer:**
 - a. The duty of honesty and fair dealing.
 - b. The same fiduciary obligation he/she owes to the seller.
 - c. Only a duty to answer questions honestly.
 - d. Only a duty to disclose any item which relates directly to the sales price of the property.
- 3. The law of agency concerns itself with the right, duties, and liabilities between and among:**
 - a. Agent and a third party with whom the agent deals.
 - b. Principal and agent.
 - c. Principal and third party introduced by the agent.
 - d. All of the above.
- 4. The position of trust assumed by the broker as an agent for a principal is described most accurately as:**
 - a. A gratuitous relationship.
 - b. A trustor relationship.
 - c. A fiduciary relationship.
 - d. An employment relationship.
- 5. Bill Harley is the agent of the buyer. He should disclose this relationship to other persons involved in a sales transaction:**
 - a. After he secures the listing.
 - b. Before escrow is opened.
 - c. Immediately after escrow has closed.
 - d. As soon as possible.
- 6. Which of the following is not an act of misrepresentation?**
 - a. Puffing.
 - b. Negligent fraud.
 - c. Conversion.
 - d. Mistake.
- 7. The word "rescind" means:**
 - a. Changed.
 - b. Terminated.
 - c. Substituted.
 - d. Subordinated.
- 8. The best way to establish an agency relationship is by:**
 - a. An oral agreement.
 - b. Voluntary by agent.
 - c. Implied contract by law.
 - d. Written contract.
- 9. An agent that does not receive a commission but is still responsible to be a fiduciary to his/her client is known as a:**
 - a. Subagent.
 - b. Gratuitous agent.
 - c. Ostensible agent.
 - d. Special agent.
- 10. Failure to disclose a material fact to a buyer or seller can be best described as:**
 - a. A nuisance.
 - b. A misdemeanor.
 - c. A violation of real estate law.
 - d. Fraud that subjects a licensee to disciplinary action, civil action and possibly criminal action.



“I am basically a full-time
psychologist who shows houses
every now and then”

— Dori Warner

CHAPTER 3: *acquisition & transfer of property*

Learning Objectives

Property may be acquired and transferred in many ways. This chapter identifies the differences between real and personal property and discusses various ways to acquire and transfer property. We review of some of the paperwork used in transferring property including details on many of the different types of deeds used in real estate.

key terms

Accession	Deed	Patent
Accretion	Emblements	Quitclaim Deed
Acknowledgment	Escheat	Sheriff's Deed
Adverse Possession	Fixtures	Trade Fixture
Alienate	Fructus naturales	Trust Deed
Annexation	Gift Deed	Warranty Deed
Bankruptcy	Grant Deed	Will
Consideration	Lis pendens	
Dedication	MARIA	

Property

The California Civil Code defines property as “the thing of which there may be ownership.” Ownership is defined as “the right of one or more persons to possess and use property to the exclusion of others.”

Property is divided into two classes:

1. Real property that which is immovable
2. Personal property that which is movable

Real Property

Real property or real estate, as it is often called, consists of:

- Land
- Anything affixed to it so as to be regarded as a permanent part of the land (fixtures)
- That which is incidental or appurtenant to the land (e.g., stock in a Mutual Water Company, easements)
- That which is immovable by law

Real property is land and all that which is attached thereto or contained therein. It includes rights for the minerals that are beneath the surface of the earth, water flowing upon it, and things of a permanent nature attached to the earth such as buildings, trees, and unsevered, unripened fruits of the soil.

Land is thought of primarily as the ground or soil upon which we walk or upon which we place structures. It also includes the air space above as a right to build to the height allowed by law, and the right to defend against the encroachment of neighbors.

Personal property provides difficulties for real estate brokers because it can be hypothecated or alienated, and could become real property. Therefore, when personal property becomes immovable, it must become real property. Often, documents become confused. Although mortgages and trust deeds are legally tied to real property, the instruments themselves are personal property.

Fixtures

Anything is considered affixed to the land when it is attached to it by roots, as in the case of trees, vines or shrubs; imbedded in it, as in the case of walls; permanently resting upon it, as in the case of buildings; or permanently attached by means of cement, plaster, nails, bolts or screws. They are called **fixtures**. Rights by others to use real property are called easements (including easements in gross) and are also a form of real property. Another name you need to know is **fructus naturales**. This legal term defines crops that are “products of nature alone.” Fructus naturales are generally classified as real property and include trees, whether deciduous (leaf shedding) or evergreen, bushes, etc.

Disputes sometimes arise as to whether a thing is or is not a fixture. The law has devised some general tests to determine this point:

1. The most important test is considered to be the intention of the person who attached the property to the land.
2. The method by which it was attached. Here the degree of permanence is important. If attached by cement, plaster, nails, bolts, or screws, it is likely classified as a fixture.
3. The adaptability of the property so attached for ordinary use in connection with the land.
4. The existence of an agreement between the parties as to the property.
5. The relationship of the person attaching the article to others with whom a dispute arises as to its character.

These five tests can be remembered by using the memory tool or acronym **MARIA**:

Method of attachment

Adaptability of the property

Relationship of the parties

Intention of the parties

Agreement between the parties

Sometimes, there may be difficulty in establishing a thing to be a fixture. The prudent broker or salesperson will avoid discord and dispute by inquiring about—and clearly specifying in the purchase agreement—the intentions of the seller and buyer concerning potentially disputable items. Persons inspecting a property with the idea of buying or making a loan are entitled to assume that whatever is attached to the structure and essential for its use is a fixture, even though that item can be removed easily. It is important to specify the status of any doubtful items in the agreement, even regarding such things as wall beds, screens, curtain rods, blinds, and sometimes even appliances connected to the structure with pipes, such as a water softener.

Property that has been determined to be a fixture merges into the land and the owner of the land becomes the owner of the fixture. The only exception to this rule is in the case of trade fixtures.

Trade Fixtures

Personal property affixed to real property for trade, manufacture, business, etc., such as a showcase permanently attached in a store, is a **trade fixture** and does not “run with the land” (become real property). A trade fixture may be removed by an owner or a tenant. If the removal causes damage or injury, the premises must be restored to their original condition. Trade fixtures that have been installed by a tenant as necessary for the tenant’s use to earn income, or that have been so designated by an agreement between the parties, should be removed from the rented premises before the expiration of the lease or within a reasonable timeframe thereafter. Those fixtures that are not removed as prescribed may become the property of the landlord as abandoned property.

Mineral, Oil & Gas Rights

Things contained in the land, such as coal, oil, minerals, etc., are real property until they are taken from the ground, at which point they become personal property. A landowner may convey the land containing or thought to contain such materials without reservation, in which case the person to whom the parcel is conveyed acquires the right to such substances. Or, the landowner may convey the land and reserve in the grant deed with the right to all minerals contained therein, including oil, by a provision in the deed often referred to as a reservation or an exception.

When such rights have been reserved by the grantor in the conveyancing instrument, the reserving party has an implied easement to enter upon the conveyed land for extracting the reserved substances, unless the reservation specifically states, “without right of surface entry.”

Emblements

Emblements can be identified as **fructus naturales** or fructus industriales. Fructus naturales would be trees, shrubs, vines and crops that are produced by nature alone, and are ordinarily considered to be a part of the land to which they are attached until they are removed, at which time they become personal property. Fructus naturales can be owned separately from the land. California Law provides that for purposes of sale, things attached to the land that are to be severed before sale or are under contract of sale are to be treated as goods and governed by the rules regulating the sale of goods, which are personal property.

The term **emblemments** are more frequently applied to crops such as grain, garden vegetables, fruit from orchards, and other growing crops that are the fruit or result of annual labor and industry. The latter are classified as fructus industriales and may be either real or personal property, depending upon the circumstances in each case. When considering the buyer and seller of land where there are such crops, these crops are a part of the land until they are removed, either physically or by agreement, and their ownership will pass to the grantee (buyer) by a conveyance of the land to another. An agreement between the seller and buyer could change this understanding. Such industrial crops are sold ordinarily by abiding by the code provisions regulating the sale of goods.

As between tenant and landlord, emblements are owned by the tenant since they are the result of efforts of the tenant.

Acquisition and Transfer of Real Property

Throughout the years of growth in our capitalistic society, the relative non-liquidity of real estate as a form of capital continues to be the economic Achilles' heel of real estate investment. A person investing in real estate accepts such a fact and pays much more attention to the amount of the investment, the cash flow the venture will produce, and the protection offered by urban land holdings and their capital improvement through inflationary trends. Downturns in California real estate prices did not affect the long-term investor who had a 10 to 15-year goal of either holding or exchanging the property.

The title to real property may be acquired in several ways, the most common of which is by deed and delivery.

Title may also be acquired by:

- Adverse possession
- Accession
- Dedication
- Will
- Inheritance
- Escheat
- Various court actions (bankruptcy, condemnation and partition action)

Title - Intangible & Abstract

Title to property may be defined as “the rights of ownership we have in anything.” As such, it is an abstract idea and cannot, of itself, be handed back and forth.

The principal rights an owner has in property are the rights to:

- Occupy and use
- Sell in whole or in part
- Refuse to sell, rent or lease
- Grant easements

- Give, abandon, improve
- Devise by will
- Exclude others from use

The owner of the title also has the right not to take any of these actions. All the above rights are commonly known as the bundle of rights. The owner is also said to hold the equity interest.

All title to property is said, at least in theory, to originate in the sovereign. Today, the sovereign is the state, or in some cases, the federal government. To pass or convey these abstract rights of ownership known as title, a written document is required. That document, called a deed, is not title itself, but is only evidence of title.

Deed and Delivery

When ownership of real property, or an interest in it, is transferred from one person to another, it is usually accomplished through a document called a **deed**. A deed is not a contract. It is a conveyancing instrument.

There are many types of deeds, including grant deed, quitclaim deed, gift deed, tax deed, etc. Whatever the type, the purpose of a deed is to pass or convey title to real property, and a deed is often referred to as a conveyance.

To **alienate** the title also means to transfer it, as by deed. The opposite of alienation is acquisition.

In addition to the obvious need for competent parties, to be valid, a deed must:

1. Be in writing
2. Contain the identity, by name or designated in such a way that it can be ascertained with certainty, of the parties (grantor and grantee)
3. Contain a granting clause
4. Give a proper description of the property
5. Be signed by the grantor (NOTE: A deed need not be acknowledged to be valid)

In Writing - Briefly, a deed is described as a written instrument, executed and delivered, by which title to real property is transferred from one person to another.

Identity of Parties - The grantor must be competent to convey title and the grantee capable of receiving the grant of the title. The identity of these parties must be included in the deed. Should the name of the grantor change while holding title, the new deed must be signed, identifying the grantor as both.

A deed to a fictitious person is void; however, a deed to an actual person by a name that person has assumed is valid. Thus, a distinction must be made between a fictitious name (valid) and a fictitious person (void). A deed is also valid even if the grantee is not named but is adequately described. A deed to “the spouse” of a named person is valid to a person by the name of his/her office; similarly, to “the pastor” of a named church is valid, and to “all the children” of a specified person is valid.

Granting Clause - A deed must contain an action word or phrase denoting the intent of the grantor to convey the property to the grantee. A deed may read: “I hereby convey” or “transfer” or “quitclaim” or “deed” or “grant.” Or, in a gift deed, “give.” These are words of transfer, and each kind of deed has its own special granting clause.

Description - There are three formal methods of describing land:

1. By government survey
2. By metes and bounds
3. By recorded map

Informal description of land, such as a street number or a name—e.g., “Blackacre Ranch”—may be used, and a deed containing such informal description could be valid and convey title. Legal description is not required. However, unless the property is described by one of the formal methods known as a legal description, it may be extremely difficult, if not impossible, to obtain a policy of title insurance or to record.

An ambiguity in a legal description of land on the face of a deed would be described as a patent ambiguity or defect. If the defect can be discovered only by reference to something other than the instrument, the ambiguity would be called latent. The ambiguity could create a cloud on the title to the property and could negate the effectiveness of the deed. It could be cured by parole or extrinsic evidence referring to admissible verbal evidence to clarify the ambiguity. There are numerous court cases where additional evidence has been accepted to remove an uncertainty in the description in a deed.

Signature of Grantor - The person signing the deed (making the conveyance) is known as the grantor, while the person receiving the deed is the grantee. A deed must be signed by the grantor—the party or parties making the conveyance of the premises. If there is more than one owner, all must sign. Both married partners must sign deeds to community property. All owners in a joint tenancy must sign to convey title to the entire holding. The same is true of tenants in common or partnership holdings, except that one may be appointed to act for the others and thus convey the property. If corporate property is sold, the corporation bylaws and constitution would indicate the names of the grantees who received the deed and who would become the grantors under a sale of the corporate property.

A forged deed is always void, even in the hands of an innocent purchaser.

Delivery

A deed, even though valid, is of no effect unless delivered and accepted. Government deeds such as tax deeds and trustee’s deeds, as well as reconveyance deeds that clear the record, must be recorded and give constructive notice.

Signing and delivery of a deed transfers title. Whether there has been a delivery sufficient to pass title depends upon the intention of the grantor. Delivery used in this connection means more than simply turning over physical possession of the deed. The grantor must have the intention to pass title. Lacking intention to deliver, the title does not pass.

There are three basic kinds of delivery:

1. Manual
2. Recording
3. Conditional

Manual delivery is accomplished by the grantor handing the deed to the grantee or by mailing it to the grantee.

Recording the deed in the county recorder's office, thus putting the title of record in the grantee's name even though the grantee may not have seen the document, would ordinarily be interpreted as evidence of a valid delivery of the deed and the title. Keep in mind that such a presumption is rebuttable in court with the presentation of sufficient evidence required for the court to determine otherwise. The legal principle is "an unrecorded deed is valid between the parties but invalid as to any subsequent recorded interests without notice."

Conditional delivery is accomplished through a third person or agent. A deed delivered directly to a grantee upon condition that the title will not pass until a certain event takes place transfers immediate title, unless the condition is mentioned in the deed and despite the intention of the grantor.

However, there may be such conditional delivery to a third party and the title would not pass until the condition was met. If a deed is delivered to an agent with instructions that it is to be given to the grantee after a certain time or event, then the transfer is not effective until the event takes place.

This does not apply to a deed delivered into escrow with instructions to give it to the grantee upon performance by the grantee. When so delivered into escrow, it becomes a proper delivery; the deed may not be recalled, although title does not pass until the grantee has performed the grantee's part of the agreement.

A deed found in possession of the grantee, or one that has been recorded, is presumed delivered. The presumption may be overcome upon proof of lack of intention to transfer title, as previously noted.

Additional Items in Deeds

While the law outlines certain specific requirements necessary to create a valid deed, there are four procedures not essential to a deed's validity that are a part of standard real estate practice, and for very good reasons. They are:

- ▢ Date
- ▢ Consideration
- ▢ Acknowledgement
- ▢ Recording

Date - A deed should be dated, although lack of a date does not invalidate the deed. If the date is missing, it is presumed to be dated on the day it was signed.

Consideration - It will be noted that consideration is not listed as one of the essentials to a valid deed. The law presumes consideration for the transfer. Frequently, a deed will state “for one dollar and other valuable consideration” to avoid mentioning the actual purchase price, but even this is not required to make the deed valid. However, lack of consideration could be of material concern where the rights of third persons are involved and may adversely affect the conveyance.

Consideration may be anything of value given or promised by a party to induce another to enter a contract. Money, services, personal or real property, and even love and affection qualify. It may be a benefit conferred upon one party or a detriment suffered by the other.

Acknowledgment - A county recorder’s office will not accept a deed for recording unless it has been acknowledged. This means that the executor—the person who executes, or signs the deed, transferring property to another—must appear before a duly authorized officer (typically a notary) and acknowledge (admit) that the executor signed the deed of the executor’s own free will. The law requires this acknowledgment to protect owners from having unwarranted or unauthorized instruments filed against their title without their knowledge or consent.

Recording - A deed need not be recorded to transfer title. Delivery constitutes transfer of title. However, for protection, it is common practice to record deeds, and the recording of a deed is necessary for title insurance purposes. Failure to record a deed may result in the grantee losing interest in the property to a subsequent good faith purchaser because the grantee failed to seek the protection afforded by the recording act.

Before a deed can be recorded, the law demands that the amount of the Documentary Transfer Tax required be stated at the top of the instrument or in an attached document. The address to which future property tax statements are to be sent is also to be identified at the top of the deed in the space provided.

Assignment Prohibited

A deed is not assignable. It is not a contract. It is a conveyancing instrument. It can only be used once and therefore cannot be assigned to another party. If the property is sold, a new deed must be made. The reason for this is that a deed must be signed by the grantor. If a person has received a deed that names the person as the grantee, that person cannot hand the deed to another person to affect a transfer, as the named person becomes a grantor and must sign a new deed. This rule applies even where the title is being conveyed back to the original grantor.

Types of Deeds

There are several types of deeds in general use in California, such as a grant deed, quitclaim deed, gift deed, trustee’s deed, sheriff’s deed, etc. All are intended to accomplish one thing—the transfer of title to real property. It is the variation of the wording of the granting clause that determines the type of deed.

Grant Deed

A deed in which the grantor uses only the words “I grant” as the action or transfer word is called a grant deed. A grant deed is used only once. It is not an assignable or negotiable instrument. Because of the magic word “grant,” this deed carries certain implied warranties as to the condition of the title that are not carried by other types of deeds. When a grantor uses the words “I grant,” the grantor is in effect warranting (guaranteeing) that:

- The grantor has not already conveyed the title to the property to any other person, and
- The estate conveyed is free from encumbrances, except for those disclosed to the grantee.

A grant deed also conveys any after-acquired title, if any such title is involved. This means that if the grantor subsequently acquires any title or claim of title to the real property that the grantor has by implication claimed to grant in fee simple, such after-acquired interest passes by operation of law to the grantee or the grantee’s successors in interest. The after-acquired title would pass to the trustee as additional security. The grantor does not warrant ownership of the title. In California, the title insurance policy is generally demanded by the buyer for this assurance of receiving title.

To repeat, usually these warranties are not expressed (stated) in the grant deed form, but are known as implied warranties, as the law makes them effective, whether expressed (written) or not.

Quitclaim Deed

In this type of deed, the grantor merely relinquishes any right or claim the grantor has in the property. If the grantor has absolute ownership, the grantor conveys absolute ownership. If the grantor has no actual claim or right in the property, the quitclaim deed transfers nothing. The granting clause contains the words “I quitclaim,” meaning “I quit any claim I have on the title to this property.”

Usually, quitclaim deeds are used to clear a land contract or some cloud, color of title, or *lis pendens* action from the record (some minor defect that needs to be removed to perfect the title). A quitclaim deed is signed by the party of record.

A **lis pendens** is a Latin expression meaning “litigation pending.” It is recorded to cloud the title in a lawsuit affecting real property. The *lis pendens* is effective until judgment has been rendered and the appeal period has expired, the plaintiff rescinds it by quitclaim deed, or it is dismissed by the court. To record a *lis pendens* action, there must be evidence of litigation.

Any conditions revealed by a title search that affect the title to property—usually relatively unimportant items but which cannot be removed without a quitclaim deed or court (quiet title) action—are said to place a cloud on the title.

A court action brought to establish title or to remove a cloud from a title is called a quiet title action. If a quiet title action is necessary, it may take a considerable length of time for the court proceedings if the purchaser chooses to contest the action (e.g., a contestant claiming title under adverse possession).

There are no implied warranties in a quitclaim deed. It guarantees nothing—not even that the grantor owns the property or any interest in it. It does not convey after-acquired title. It is often used as a quick solution to a quiet title action.

Gift Deed

A grantor may make a gift of the property to the grantee using a grant deed or quitclaim deed form for the purpose. A grantor may (but need not) say the transfer is made in consideration of “love and affection.” A gift deed is valid unless made to defraud creditors, in which event it may be voided by the creditors. The granting clause contains the word “give” or some similar word.

Other Types of Deeds

Usually given in court proceedings, there are other deeds bearing such designations as sheriff’s deed, tax deed, executor’s deed, etc. These include:

Tax Deed - One given because of a tax sale of property.

Sheriff’s Deed - The deed given by court order for the sale of property to satisfy a judgment.

Guardian’s Deed - Used by a duly appointed guardian to transfer the property of a minor child or incompetent person.

Administrator’s Deed - One used when selling property during the administration of the estate by a court-appointed representative.

Executor’s Deed - Used when the property of a deceased person is sold by the executor named in the will of a deceased person.

Warranty Deed A deed used to convey real property that contains express warranties of title and quiet possession. The grantor agrees to defend the premises against the lawful claims of third persons. It is commonly used in other states, but not in California, where it has been supplanted by the grant deed. The modern practice of securing title insurance has reduced the importance of warranty deeds.

Trust Deed - Conveys bare legal title (but no possession) of a property to a trustee (third party) as security for a loan and differs from other deeds in that the legal title only is conveyed. A trust deed is a security device and a lien. It differs from other deeds in that the trust deed and note for which it was given as security may be assigned.

Trustee’s Deed - This deed is executed by the trustee named in a trust deed when the borrower has defaulted in repayment of a loan; the trust deed is foreclosed, and the property is sold to the highest bidder at a trustee’s sale.

Patent - A grant from a sovereign. In American Law, the instrument by which a state or government grants public land to an individual.

Questions on Grant Deed

1. Is the deed invalid if the amount of consideration is not stated?
NO. Statement of consideration is not essential to a deed.
2. Is the property description sufficient to be recorded as a valid deed?
YES. The deed may be valid for recording purposes, but not for title insurance purposes.
3. Can this deed be recorded?
YES. Under recording laws where two or more persons execute an instrument by which property rights are affected, such instruments are entitled to be recorded if acknowledged by any one of such persons.
4. What would be the effect if buyers do not record?
The title would remain of record in the grantor's name. The buyer runs the risk of losing title to an innocent third party.
5. Is the deed properly signed?
YES. Both grantors, husband and wife, have signed. Ordinarily, grantees do not sign.
6. How is title vested by this deed?
As community property since no vesting is stated and the Browns are husband and wife.
7. If the deed is not dated, would it be a good deed?
YES. Since the deed was notarized on January 1, 2015, it must be presumed it was signed on that date. This deed is dated 1/1/2015.

Recording Requested By:

When recorded mail document to:

NAME Jonathan and Margaret Brown

ADDRESS P.O. Box 515

CITY San Bernardino, California
STATE & ZIP 92404

Above Space for Recorder's Use Only

GRANT DEED

THE UNDERSIGNED GRANTOR(S) DECLARE(S)

DOCUMENTARY TRANSFER TAX is \$ 55,000

CITY TAX \$ 0.00

- computed on full value of property conveyed, or
- computed on full value of items or encumbrances remaining at time of sale,
- Unincorporated area City of _____, and

FOR A FULL VALUABLE CONSIDERATION, receipt of which is hereby acknowledged,
Five hundred Thousand Dollars (\$500,000)

hereby GRANT(s) to Johnathan and Margaret Brown, husband and wife

the following described real property in the City of San Bernardino County
of San Bernardino, State of California:

As shown in Exhibit "A" attached hereto and made a part hereof, and commonly known as The Norton
Ranch, situated in Section 16, range 1E, San Bernardino B&M

Sam Smith
Sam Smith

Sally Smith
Sally Smith

Dated: 1/1/2015

STATE OF CALIFORNIA
COUNTY OF San Bernardino } SS.

On January 1, 2015 before me, John Doe a Notary Public, personally
appeared Sam Smith & Sally Smith who proved to me on the
basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within
instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized
capacity (ies), and that by his/her/their signatures(s) on the instrument the person(s), or the entity
upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing
paragraph is true and correct.

(SEAL)

WITNESS my hand and official seal.

Signature John Doe



MAIL TAX STATEMENTS TO ADDRESS AS SHOWN ABOVE

Other Methods of Acquiring Title Without a Deed

Adverse Possession

Adverse possession is a method of acquiring title to property without a deed. Before this law was codified and written into the California statutes, title could be obtained by adverse possession by the adverse possessor using the property for 20 years.

The current law requires strict observance of certain provisions because the title is being transferred as an **operation of law** without the consent of the holder of the title and without any court action. For title to transfer by this method, the **adverse possessor** must comply with these four requirements:

1. **Color of Title or Claim of Right** - The adverse possessor cannot simply choose a parcel of unoccupied land and take possession. The adverse possessor must have some basis for claiming title. This basis may be some defective written instrument (color of title) or some right, no matter how erroneous (claim of right).
2. **Open and Notorious Occupancy** - Physical occupation and use of the property as if it were owned by the adverse possessor is required. If it is a residence, the adverse possessor must live in it. If it is a farm, the adverse possessor must farm it, fence it in, etc. Personal occupation is not essential. Possession may be by a tenant of the person claiming by adverse possession. In any case, the occupancy must be adverse and hostile to the owner.
3. **Five (5) Years** - The occupancy must be for five continuous years.
4. **Payment of Property Taxes** - During the five-year period, the adverse possessor must pay the real property taxes on the property as they become due. The fact that the owner of record is also paying the taxes would not mean that the adverse possessor had not complied with this requirement.

Since title by adverse possession cannot be traced through county records, it is neither marketable nor insurable until perfected by court decree. To perfect a title, the adverse owner should institute a **quiet title action** in court based upon adverse possession, and, when judgment is rendered, enter the judgment of record. Another method of perfecting title would be by receiving a quitclaim deed from the record title owner, though this is somewhat of a remote possibility.

Over a period of years, the laws of California have been interpreted to mean that land held for public use cannot be taken under a claim of adverse possession.

Accession

Title may be acquired by **accession** through annexation or accretion. Acquisition of title by **annexation** occurs when a tenant attaches personal property to the land of another without an agreement permitting the tenant to remove it. The thing so affixed belongs to the owner of the land unless the owner requires the former tenant to remove it. Until 1953, there was no compensation for the innocent improvement of another's land, but the legislature has now

provided that where such improvements are made in good faith, mistakenly believing there was a right to do so, the maker of the improvements may remove them upon payment of any damages resulting from the removal of the improvements.

Acquisition of title by accession may also be in the form of **accretion**, where from natural causes, land forms by imperceptible degrees upon the bank of a river or stream caused by the action of the water in washing up sand, earth, and other materials on the shore. Such added land becomes the property of the owner of the waterfront property.

Dedication

A **dedication** may be defined as “the devotion of the land to public use (for streets, alleys, bridges, parks, squares, wharves, playgrounds, schools, etc.) made by the owner and accepted for such use by or on behalf of the public.” Dedication may be by voluntary or statutory procedure.

Voluntary dedication occurs when the public acquires the use of land through a gratuitous act of a private landowner. No form of conveyance is required. It is accomplished by the act of the owner, as indicated by the owner’s word or deed in dedicating the owner’s land for public use, and the acceptance by the public authority for such use.

Statutory dedication is accomplished under, and in conformity with, the provisions of a statute regulating the subject. Most statutory dedications are done in compliance with subdivision laws. In order to comply with the procedure for statutory dedication, four requirements must be met:

1. **Map of Property** - A map of the property must be supplied, showing the portion of land to be dedicated, together with its legal description. The map would show the streets and other easements to be dedicated for public use, including utility lines.
2. **Offer of Dedication** - Attached to the map, there must be an Offer of Dedication signed by every person who holds any interest in the property. This would include the titleholder or those who hold easements, trust deeds, etc.
3. **Acceptance of Dedication** - Attached to the map, along with the Offer, must be a Certificate of Acceptance signed by the local governing body (in the city, city council, county, or the board of supervisors).
4. **Recordation** - The last act required to accomplish statutory dedication is the recording of the map with the Offer and Acceptance attached. If not recorded, dedication has not taken place.

Traditionally, dedication in either of these forms, voluntary or statutory, is not a conveyance of fee title but rather an **easement** (right to use). If the land is abandoned for the specific public use for which it was dedicated, it reverts to the donor. Many local governmental bodies are now requesting a deed so that fee title, rather than an easement, may be acquired. Where property is acquired by deed, abandonment of the use of the property for which it was dedicated does not cause it to revert to the donor. Title remains in the governing body, which may then use the property for other purposes, or even sell it.

Will or Intestate Succession

Titles acquired by will or intestate succession are those recognized and effected during probate of an estate in the Probate Department of the Superior Court. **Intestate succession** is the acquisition of title to the property of one who dies without disposing of it by will. Special rules affect succession, depending upon the character of the property and the relationship of the heirs at law or next of kin.

Escheat

The state may acquire the property of persons dying without a will and without heirs by a method called **escheat**. The title is said to “revert to the state.” The deceased must leave no heirs or have only alien heirs who do not reside in this country and who are citizens of a country that does not allow United States citizens to inherit property located in that country. However, the process of escheat is not automatic. Legal proceedings must be held, instituted either by an action filed by the Attorney General or by “Decree of Distribution” by the probate court. Once there has been such legal action, the distribution or decree does not become final for five years, during which time a claimant may bring legal proceedings to recover or redeem the property. Where the State gains title by escheat and later sells the property, the grantee receives a State Comptroller’s deed.

Court Action

Courts are often called upon to establish legal title, regardless of the desires of record owners (such as in a quiet title action, as explained under “Adverse Possession”), to clear the title of a seller under a forfeited recorded land contract of sale, or to remove easements or restrictions of record.

Courts are also called upon where a co-owner of a property requests a severance of the respective interests. If the property cannot be divided physically, the court may order a sale and divide the proceeds among the former owners. This is called a **partition action**. Such action may be brought by tenants in common and joint tenants, but not by owners holding as community property.

Court action is also required in the case of a mortgage foreclosure, foreclosure under a mechanic’s lien, or a judgment lien, where the property is to be sold to produce money to pay the delinquent lien. Court action is not required to foreclose and sell property at a trustee’s sale in the foreclosure of a trust deed, as the title is transferred to the buyer by the trustee and not by the court.

Another court proceeding that can bring about the transfer of title is one taken under the sovereign power of eminent domain. A public entity sometimes needs privately owned land for some necessary public use. Should the public entity be unsuccessful in negotiating with the owner for the purchase of such land, it will then file a condemnation action in court against the property owner. If the court action is successful, title will pass to the public entity upon payment of the fair market value of the property determined by court.

Public buildings that have been acquired through eminent domain action occasionally must be disposed of by public authority. Such sales are usually conducted by sealed bids. Public

notice is given, inviting sealed bids for the purchase of excess public lands. The notice sets a date on which the bids will be opened. The sale will be concluded with the person submitting the highest sealed bid.

Bankruptcy Proceedings

The Federal Bankruptcy Act recognizes three types of proceedings:

1. Straight bankruptcy (liquidation): Chapter 7
2. Reorganizations: Chapter 11
3. Consumer debt adjustments: Chapter 13

This law also created a U.S. Bankruptcy Court in each federal judicial district in the country.

A liquidation proceeding, ordinarily referred to as a straight **bankruptcy**, is introduced under Chapter 7 of the Bankruptcy Act. Such proceedings can be initiated voluntarily by the bankrupt party or involuntarily by the action of the bankrupt's creditors. In these proceedings, debtors disclose all the assets they own (the bankruptcy estate) and deliver them to the bankruptcy trustee. The ownership of these assets passes to the trustee. The trustee identifies certain property that the debtor can retain and then administers, liquidates, and distributes the remaining assets to the benefit of the creditors.

The Bankruptcy Law provides a means for establishing the relative rights of creditors, for recovering any preferential payments made to creditors or improper transfers of property to others, and for setting aside any preferential liens obtained by creditors. What normally happens is that if bankrupt parties have been honest in their business dealings and in the bankruptcy proceedings, and if there are no objections from creditors, they are usually given a discharge (relieved) of their debts. This relief is effective as of the date of the discharge by the Bankruptcy Court.

The filing of a bankruptcy petition operates as an automatic stay that is effective as of the date of filing to certain kinds of creditors' actions against the bankrupt debtors or their property. Some of these would be:

- ▢ Actions to begin or continue judicial proceedings against the debtor.
- ▢ Actions to create, perfect, or enforce a lien against the debtors' property (foreclosure actions) without court permission.
- ▢ Actions to set off indebtedness owed the debtor that arose before the start of the bankruptcy proceeding.

You should recognize that certain obligations are not affected by the discharge of a bankrupt debtor. Among non-dischargeable debts would be:

- ▢ Debts due as a tax or fine to any federal, state, or local government unit.
- ▢ Debts that result from liabilities for obtaining money by false pretenses and misrepresentation.
- ▢ Debts due for alimony or child support.

- Debts not scheduled in time for proof because the creditor was not notified of the bankruptcy proceeding, even though the debtor knew that the debtor owed the money to the creditor.
- Debts incurred after the bankruptcy proceeding was initiated.

Should bankrupt debtors transfer property or incur obligations with intent to hinder, delay, or defraud creditors, such transfers are voidable by the bankruptcy trustee. Examples of this would be transfers of property for less than its reasonable value within a year of filing the petition in bankruptcy.

notes:

Chapter 3 Summary

Real property or real estate, as it is often called, consists of land, anything affixed to it so as to be regarded as a permanent part of the land (fixtures), that which is incidental or appurtenant to the land (e.g., stock in a Mutual Water Company, easements), and that which is immovable by law.

Ownership includes the right to use, possess, enjoy, transfer, and dispose of a thing to the exclusion of others. The ownership of land also includes the right to the subjacent support from adjoining land. The ownership of land is absolute and unconditional from the center of the earth to the outer reaches of space.

According to the Civil Code, "Every kind of property that is not real property is personal property."

These five tests to determine real or personal property can be remembered by using the memory tool or acronym **MARIA**:

- Method of attachment
- Adaptability of the property
- Relationship of the parties
- Intention of the parties
- Agreement between the parties

To alienate the title also means to transfer it, as by deed. The opposite of alienation is acquisition.

A **grant deed** may convey the land and reserve the right to all minerals contained therein, including oil, by a provision in the deed often referred to as a reservation or an exception.

California Law provides that things attached to the land that are to be severed before sale or are under contract of sale (i.e., crops) are to be treated as goods and governed by the rules regulating the sale of goods, which are personal property.

A forged deed is always void, even in the hands of an innocent purchaser.

A deed, even though valid, is of no effect unless delivered and accepted.

A deed need not be recorded to transfer title. Delivery constitutes transfer of title.

A **quitclaim deed** merely relinquishes any right or claim the grantor has in the property.

A court action brought to establish title or to remove a cloud from title is called a **quiet title action**.

chapter 3 quiz

1. Legally, property is:

- a. Real that is tangible.
- b. Personal – fixtures.
- c. Personal if not real.
- d. All of the above.

2. Mortgages and trust deeds are:

- a. Personal property without exception.
- b. Real property in most cases.
- c. Chattels real.
- d. Always real property

3. The right to use, possess, enjoy, transfer, and dispose of a thing to the exclusion of others best defines:

- a. An estate.
- b. Real estate.
- c. Ownership.
- d. Equity.

4. The principal difference between real property and personal property is:

- a. Value.
- b. Permanence.
- c. Length of life.
- d. Mobility.

5. Stock in a mutual water company:

- a. Requires a separate written contract to convey to the buyer.
- b. Is appurtenant to land and thus automatically transfers to the buyer.
- c. Must be mentioned in the deed in order to transfer it to the buyer.
- d. Must be owned as tenants in common.

6. The following is real property:

- a. Leasehold.
- b. Chattel real.
- c. Debts
- d. Planted trees.

7. Personal property provides difficulties for real estate brokers because it:

- a. Can be hypothecated.
- b. Can be alienated.
- c. Could become real property.
- d. All of the above.

8. A grant deed passes title when it is:

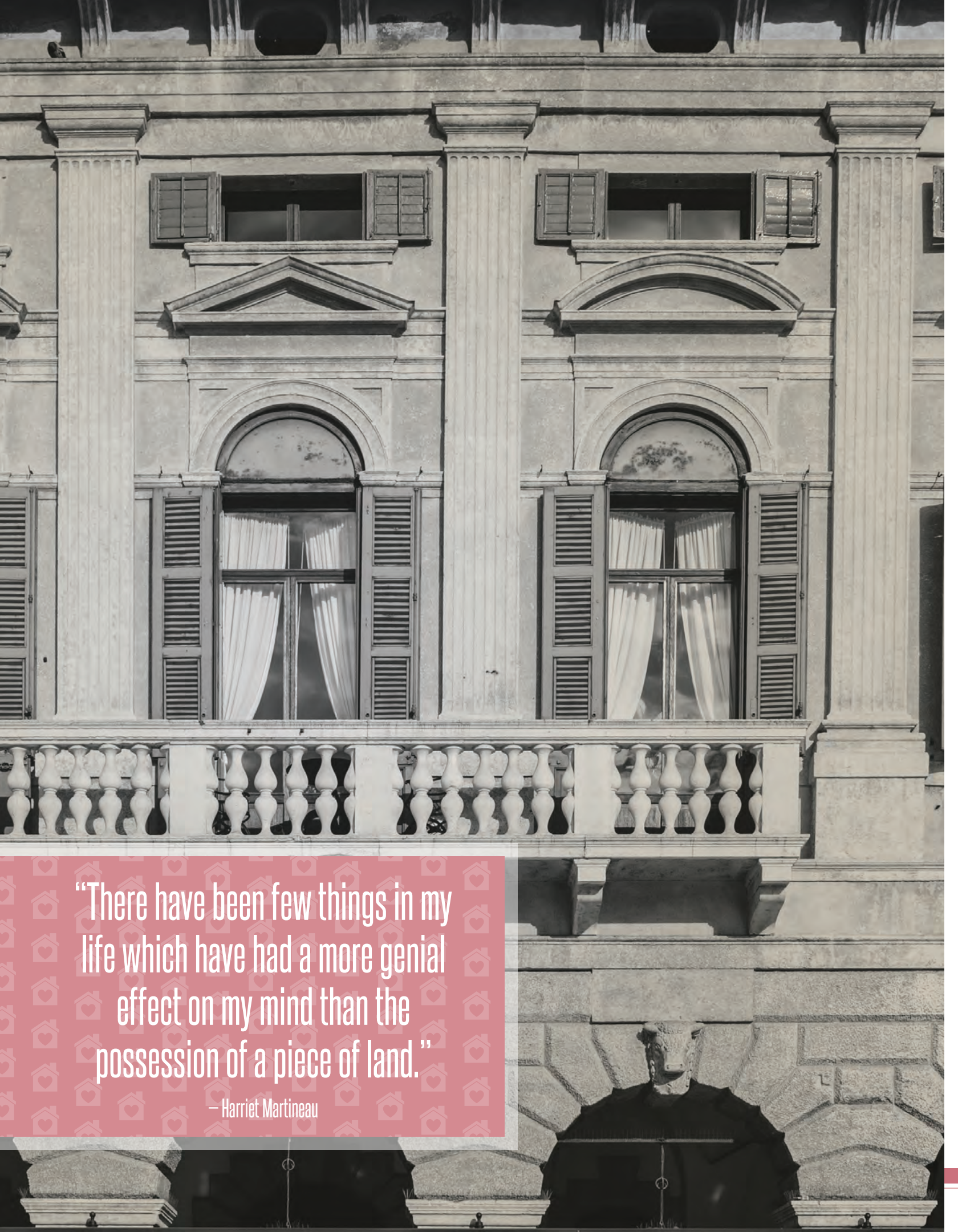
- a. Executed.
- b. Delivered.
- c. Recorded.
- d. Acknowledged.

9. The following word is most nearly the opposite of alienation:

- a. Acceleration.
- b. Amortization.
- c. Acquisition.
- d. Avulsion.

10. The primary purpose of a deed is to:

- a. Move title.
- b. Encumber a property.
- c. Secure a lien on a property.
- d. Grant a person the use of a property, but not to have title to it.



“There have been few things in my life which have had a more genial effect on my mind than the possession of a piece of land.”

— Harriet Martineau

CHAPTER 4:

property & estates

Learning Objectives

Interests in real estate vary. These interests can be held by individuals, groups, entities or by a combination of any of these. This chapter examines the various ways interests in real estate can be held. Also discussed are lease terms that are in common use in our industry.

key terms

Alienate	Fee simple estates	Net lease
Chattels real	Freehold estate	Percentage lease
Demise	Graduated lease	Periodic tenancy
Estate at sufferance	Gross lease	Run with the land
Estate at will	Intestate succession	Sale leaseback
Estate for years	Lease with option to purchase	Sandwich lease
Estate in remainder	Leasehold	Security deposit
Estate in reversion	Less than-freehold	Statute of Frauds
Estate of inheritance	Life estate	Unlawful detainer

Interests in Estates

The term estate signifies the degree, quantity, nature, and extent of interest that a person may have in real property.

An interest in real property may consist of ownership, or it may concern the use of property only. Where the interest consists of ownership, it is called a **freehold estate**. Where it consists of only the right to use the land, it is called **less than-freehold**.

Freehold (Ownership) Estates

There are two types of interests in real property that are designated as freehold estates and thus concern ownership or title to real property. These are known as **fee simple** estates and **life estates**.

Fee Simple Estate

This is the greatest ownership a person may have in real property. The outstanding characteristics of a fee simple estate are that it is inheritable, freely transferable, and of indefinite duration.

The word fee is one of those words handed down to us from feudal times. A king might give one of his/her subjects a parcel of land on condition that the subject render a specified kind of service in return. Such land was known as a fee. The land so given was controlled by its owner absolutely, with the right to pass it on to the owner's heirs to hold and control. In modern times, such an estate is known as a fee simple or fee. Because such an owner can dispose of the estate while living by estate sale, by gift, or upon death by will or **intestate succession**, it is sometimes called an **estate of inheritance**.

When the owner of the fee holds it without qualification, it is called an estate in fee simple absolute. A fee simple absolute is free of any deed restrictions.

When the owner of the fee holds it with a qualification, it is called a fee simple subject to a condition subsequent. An example is when the grantor has conveyed the land for “so long as” it is not used for the sale of alcoholic beverages. A court action must be instituted by the former grantor before this condition can be exercised.

Life Estate

A **life estate** is an estate in real property created by deed or devise (will) by which the grantee has all the rights of possession, use, and income during the grantee’s life or the lives of other designated persons.

A life estate is freehold if the person giving the life estate designates that the title is to go to some other person upon the death of the life estate holder. The person so designated is said to have an **estate in remainder**. If no designation is made, the estate that remains is called an **estate in reversion**.

A lease given or a sale made on property that is held as a life estate terminates upon the death of the holder of the life estate and is not binding upon the holder of the estate in reversion or in remainder.

It is also possible for a life estate holder to encumber the property by making it security for a loan, but such encumbrance would not be effective against the property when the holder dies, and a lender (if one could be found) would probably require the additional security of a life insurance policy to insure repayment of the loan. The holder of a life estate may sell his/her interest. However, a holder cannot convey more than the holder has and upon the holder’s death, the rights of any buyer would terminate.

The estates discussed above involve the title to real property and are generally created by a conveyance (deed). However, they also may be created by the will of a deceased person.

Less Than Freehold Estates

There are other interests in real property that do not involve title to property although they may be of great value. Principally, these would be leases. A lease is personal property. It is sometimes referred to as **chattels real**.

A **sale leaseback** occurs when a company wants to create cash flow but does not want to give up the occupancy of a building they own; thus, a sale leaseback is arranged. The investor buys the building from the owner who, in the same escrow transaction, leases back the building over a long period of time.

A **lease** or **leasehold** is a contract between an owner or landlord, known as the lessor, and the tenant or renter, called the lessee. The lease must include the names of parties, description of the property, amount of rent, method of payment, and length of term.

The term **demise** means to convey an estate such as a lease. The term **alienate** means to convey title to property.

There are two basic types of leases: An **estate for years**, ordinarily called a term lease, and a **periodic tenancy**. These are also referred to as definite and indefinite leases.

An estate for years or term lease has a label that is somewhat misleading because the period may be for less than a year, measured in days, weeks, or months. An estate for years ends at the expiration of the term and without notice.

A periodic tenancy continues from one period to the next, which might be year to year, month to month, or week-to week. The periodic tenancy continues until either the landlord or the tenant terminates the agreement. Usually, the rental period determines the length of time for the required notice of termination. In the absence of a written document for a lease of a single- family residence, there is a presumption that it is a month to month tenancy.

An **estate at will** is one that is terminable at the will or unilateral decision of the lessor and at the will of the lessee, with no agreed-upon period of duration. California requires a written notice of not less than 30 days prior to the action to vacate to be served upon the tenant. The 30 day notice may be served on the tenant at any time during the rental period. The tenant needs to give a 30-day notice of termination also.

An **estate at sufferance** is one in which the lessee, who has rightfully come into possession of the property, retains possession after the expiration of the term of the agreement without the lessor's consent. A notice of termination is not necessary.

A lease for agricultural purposes is normally limited to 51 years. Leases for all other purposes may not exceed 99 years.

The **Statute of Frauds** requires that leases for more than one year be in writing to be enforceable.

Leases for a term of one year or less may be oral. The law presumes monthly tenancy.

In the case of a written lease, the instrument must be signed by the lessor. It is not necessary that the lessee sign the lease. The fact that the lessee enters into possession and pays the rent is evidence of the acceptance of the agreement, even though the lessee has not signed the instrument.

The commission charged by a broker for negotiating the terms of a lease agreement is usually based upon a percentage of the rents for the full term of the lease. Commission for the entire period of the lease is normally paid at the time the lease is signed.

The county recorder will not accept a real property lease for recording unless it has been acknowledged by the lessor before a proper official.

In the case of a term lease for a longer period, the terms need to be itemized. Specific terms can include whether the lessee can assign or sublet, by whom the taxes will be paid, public liability provisions, position of each party in case of damage by fire or earthquake, removal of fixtures, etc.

Assign or Sublet

Unless specifically prohibited by the terms of the lease, the property can be sublet by the lessee, or the lessee may assign the lease. There is a distinct difference. If the lessee sublets, the lessee remains the lessee and an interested party. If the lessee assigns, the lessee transfers all rights to the new tenant (assignee) and the lessee's obligation to pay rent comes to an end when the lessor consents to the assignment. Any easement or other rights given by a lessee or sublessee are limited in time to the term of the original lease.

Lease Terms

An **index lease** is tied to a recognized national index (e.g., the cost of living index), and the rental is adjusted in accordance with the movements of this index.

The **graduated** or step up lease provides that rents shall be increased at various stipulated times in the future.

A lease of land only would not be a depreciable investment and would be somewhat like an annuity.

A **net lease** is a rental agreement in which, in addition to the rental charge, the tenant pays some or all the property taxes, the fire insurance premiums, and property maintenance expenses. If all three are paid by the tenant, this arrangement produces net income to the landlord. It is often referred to as a triple net lease, or a net, net, net lease.

A **gross lease**, on the other hand, is a lease which obligates the lessor to pay all or part of the expenses of the leased property such as utilities, fire insurance, maintenance, real property taxes, etc.

When a lessee or sublessee sublets the property, it is said that the lessee or sublessee holds a **sandwich lease**, and would be both a lessor and lessee at the same time.

Many leases are for a stated period with an option for an additional period on the same terms and conditions, or at an increased rental. Others provide for the purchase of the property by the lessee during the term of the lease, if the lessee so desires, with price and terms stated. The latter is known as a **lease with option to purchase**. If the lease with an option to purchase is assigned by the lessor, in the absence of an agreement prohibiting the assignment, the option would "follow with the sale." The buyer would take title subject to the lessee's exercise of the rights of purchase.

Lease Renewal

An entirely new instrument should be written when a lease is renewed. When a lease is extended, the tenant remains in possession under the old terms and the extension is effected by an agreement signed on, or attached to, the original lease. Transfer of title by sale does not terminate a lease unless specifically provided for in the rental agreement.

In the case of a rental agreement for an unspecified term such as a month to month tenancy, the landlord can raise the rent by giving the tenant 30 days written notice of a change of the terms. The law requires that the landlord also give the tenant a 30 day written notice of termination of tenancy. A 60-day written notice of termination is required if the tenancy was

for one year or more. The tenant needs to give only a 30-day notice. If the rental period is for a shorter term, then the notice period is the length of the rental period. For example, a one-week tenancy requires only a 7-day notice to terminate. The notice required does not have to be served on the anniversary date of the payment of the rent.

A lease for a specified term (estate for years) ends at the expiration of the term and without notice. If the tenant breaches any covenant or condition of the lease or is in default in rental payment, the landlord is required to give the tenant only a 3-day notice in writing, requiring that the tenant comply with the terms of the lease or return possession of the property.

If a landlord should evict a tenant unjustly, the tenant may sue for damages for wrongful eviction, sue for restoration of possession of the premises, or stop possession and pay no further rent.

Notices, whether of the variety to end a month to month tenancy or the 3 day notice for breach or default, must be in writing and served personally upon the other party. Mailing or posting of such notice is not permitted, except in special circumstances such as service by publication or agreement between the parties. The notices required may be served by the lessor or any other person over 18 years of age. It is advisable to have some disinterested party serve the notice as the service may have to be proven in court.

If a tenant fails to pay rent, the landlord may serve a 3 day notice to pay rent or quit; if a tenant violates some other lease condition, a 3 day notice to quit is used. Failure to comply with such a notice entitles the landlord to start an **unlawful detainer** action in court.

As a result of an unlawful detainer suit, the court may issue a writ of possession which, when served by the sheriff, results in eviction of the tenant from the premises within 5 days after service. At the time the writ is issued, the court may also render judgment for the amount of damages and rent found due, or for three times the amount of rent. Death of either party does not cancel a lease. The heirs and assignees of the lease have full rights until the lease is terminated either by action of law or by its terms.

If a lessee abandons the premises, the lessor cannot immediately consider a loss of the rent for the remaining term. The lessor may, after notice of default to the lessee, re-rent the property, keeping the right to collect from the original lessee the difference between the agreed-upon total rental and what the lessor received. The lessor may also, if desired, leave the property vacant and sue for each month's rent as it becomes due and remains unpaid. The lessor has a third option: to accept the abandonment and take possession, in which case the lease would be terminated.

Unless so provided, the lessor cannot take possession of a tenant's personal property for failure to pay rent, except in the case of inns, hotels, boarding houses, furnished and unfurnished apartments, etc. Keepers of such establishments have liens on the baggage and other property of their tenants for rent and charges, except for certain items exempt by law such as musical instruments used to earn a living, prosthetic or orthopedic appliances personally used by a guest or lodger, and certain other items specified in the code.

Most leases provide that the lessor may enter and inspect the property as desired, but the lessor must permit the tenant the quiet enjoyment of the premises without harassment, such as threatening expulsion or attempting to lease to others. This could constitute constructive eviction, giving the tenant the right to move.

In every lease, the law implies a covenant on the part of the lessor for the quiet enjoyment and possession of the property by the lessee during the term of the lease. It is a warrant by the lessor against the lessor's own acts, not those of strangers.

The law requires that the lessee take reasonable care of the premises and not commit any damages beyond ordinary wear and tear.

Lessee May Make Repairs

If, within a reasonable time after notice to the lessor of dilapidations that the lessor ought to repair and the lessor neglects to do so, the lessee may personally make the requested repairs, where the cost of such repairs does not require expenditure of greater than one month's rent. The lessee may then deduct these expenses from the rent or vacate the premises. If the lessee vacates under these conditions, the lessee will be relieved from the obligations as a lessee.

If a lessee acts to repair after the 30th day following notice, the lessee is presumed to have acted after a reasonable time.

Recent cases have held, however, that there is a common law warranty in behalf of a lessee of residential property that the property comply with Health and Safety Code requirements. If it does not so comply, the lessee has a defense against an unlawful detainer action for non payment of rent and, in fact, the lessor may not be entitled to any rent while the property remains in such condition.

The lessor is liable for injuries resulting from a defective condition in the area that the lessor retains control, such as stairs and common hallways. This is true in every case except when a private dwelling house is leased for occupancy by one family only.

A **security deposit** is an amount of money deposited with a lessor to secure the performance of the lease terms, and/or the "cleanup" of premises. It is not rent and belongs to the lessee. The law establishes that the tenant has a priority claim on it. A deposit is refundable. It is not a fee. It is held by the lessor only as security against any money that might be due to the lessor after the tenant vacates. If the tenant damages the property or is behind in rent, for example, the lessor may apply the deposit towards those amounts. Any unused portion of the deposit must be returned to the tenant within 21 days after the tenant vacates the premises.

Rent is the consideration paid for use of property. In either an oral or written agreement, it is important to state specifically when the rent is to be paid to the landlord. Without written conditions to the contrary, if the holding is by the day, week, month, quarter or year, rent is payable at the termination of the respective periods as it becomes due.



CAR LR Lease Ageement:
<http://lumbleau.com/Lease-Agreement>



Percentage Lease

A **percentage lease**, usually employed when leasing retail business property, makes use of a percentage of the gross receipts of the business to determine the rental payment. Such lease agreements should also require that there be a fixed minimum rental for each payment period.

The term **“run with the land”** refers to the rights of a person upon transfer. Rights are not eliminated simply by transfer of the title. Leases continue after the transfer of title, as do mineral rights (unless exempted), stock in a Mutual Water Company, and easements.

Chapter 4 Summary

A **life estate** is an estate in real property created by deed or devise (will) by which the grantee has all the rights of possession, use, and income during the grantee's life or the lives of other designated persons.

A lease given or a sale made on property that is held as a life estate terminates upon the death of the holder of the life estate and is not binding upon the holder of the **estate in reversion** or in remainder.

A lease is personal property. It is sometimes referred to as **chattels real**.

A **lease** or **leasehold** is a contract between an owner or landlord, known as the lessor, and the tenant or renter, called the **lessee**.

An estate for years or term lease has a label that is somewhat misleading because the period may be for less than a year, measured in days, weeks, or months. An estate for years ends at the expiration of the term and without notice.

The **Statute of Frauds** requires that leases for more than one year be in writing to be enforceable.

The **graduated** or step up lease provides that rents shall be increased at various stipulated times in the future.

In a **net lease**, the tenant pays some or all the property taxes, the fire insurance premiums, and property maintenance expenses. It is often referred to as a triple net lease, or a net, net, net lease.

A **gross lease** obligates the lessor to pay all or part of the expenses of the leased property such as utilities, fire insurance, maintenance, real property taxes, etc.

A **percentage lease**, typically used with retail business property, makes use of a percentage of the gross receipts of the business to determine the rental payment.

If a tenant fails to pay rent, the landlord may serve a 3 day notice to pay rent or quit; if a tenant violates some other lease condition, a 3 day notice to quit is used. Failure to comply with such a notice entitles the landlord to start an **unlawful detainer** action in court.

notes:

chapter 4 quiz

- 1. Fee simple estate most closely refers to:**
 - a. The greatest interest a person can own in land.
 - b. An easy way to transfer title to land.
 - c. An expensive way to transfer title to land.
 - d. A common way to hold title to land.
- 2. The following would possess an “estate” in real property:**
 - a. A beneficiary.
 - b. A mortgagee.
 - c. A life tenant.
 - d. All of these.
- 3. The owner of a leasehold estate is the:**
 - a. Remainderman.
 - b. A lessor.
 - c. Reversionor.
 - d. Lessee.
- 4. All of the following are classified as real property, except:**
 - a. Mineral, oil and gas rights.
 - b. A leasehold on a residence.
 - c. Uncultivated fruit trees.
 - d. An easement appurtenant.
- 5. The following would be an estate in real property:**
 - a. An easement.
 - b. The privilege to use another’s property.
 - c. A lease.
 - d. All of the above.
- 6. The term demise means to:**
 - a. Alienate.
 - b. The intestate.
 - c. Appoint an executor.
 - d. Appoint an administrator.
- 7. The distinguishing characteristic between classes of less than freehold estates is:**
 - a. Month to month and year to year.
 - b. Estate for life and periodic tenancy.
 - c. Definite and indefinite.
 - d. Periodic tenancy and month to month.
- 8. Which of the following is not required to create a lease for more than one year:**
 - a. It must be in writing.
 - b. Lessor and lessee must both sign it always.
 - c. A termination date.
 - d. The amount of rent and the method of payment.
- 9. Through a valid contractual assignment of a lease, the assignee purchases the leasehold interest and becomes a:**
 - a. Landlord.
 - b. Guarantor.
 - c. Sublessee.
 - d. Tenant.
- 10. The person hiring real property from its owner (lessee) is given an exclusive right to use. He/she is a:**
 - a. Tenant.
 - b. Licensee.
 - c. Lodger.
 - d. None of the above.

Last Will and Testament

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“In a crowded marketplace, fitting in is a failure. In a busy marketplace, not standing out is the same as being invisible.”
— Seth Godin

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CHAPTER 5: *ownership – easements & wills*

Learning Objectives

The property rights of real estate owners vary by the rights transferred when the property was acquired. This chapter discusses the many ways title to real estate can be held and transferred, sometimes after death. We also review restrictions or easements that may be involved in the ownership of real estate.

key terms

Ambulatory	Easements in gross	Lineal
Attorney-in-fact	Emancipated minors	Partnership
Bequeath	Escheat	Power of attorney
Codicil	Executor	Servient tenement
Community property	Executrix	Severalty
Devise	Homestead	Statute of Frauds
Dominant Tenement	Joint tenancy	Statute of Limitations
Easement	License	Tenancy in Common

Ownership of Real Property

All property has an owner. It may be the federal, state, or local government, or some private organization or person. Property owned by the government is called public property.

Two basic kinds of ownership are recognized:

1. severalty ownership
2. co-ownership.

Severalty

Severalty is the technical name given to ownership by one person only.

The “person” owning the property in severalty may be a natural person (any human) or a legal person (a corporation). All government property is owned in severalty.

Co-Ownership

Co-ownership, in contrast to severalty, describes simultaneous or concurrent ownership of a parcel of property by two or more persons.

There are four types of co-ownership:

1. tenancy in common
2. joint tenancy
3. community property
4. tenancy in partnership.

There is only one thing that is common to all four types of co-ownership: All co-owners have an equal right of possession in the property. Equal right of possession means that all co-owners, however large or small their interest may be, have the right to occupy and use the entire property.

As co-owners, the parties under all four types of co-ownership have certain rights and certain obligations or responsibilities. They have the right of possession without payment of rent to the other co-owners and the right to receive their proportionate share of any income that may be received. Co-owners have the responsibility or duty to contribute their proportionate share of all costs of maintaining the property and paying taxes. The co-owners have the right to enforce contribution to the costs from their fellow co-owners.

There is no legal limit as to the number of co-owners there may be as tenants in-common, joint tenants, or tenants in partnership.

Tenancy in Common

Tenancy in common is a method for two or more persons to hold title to the same parcel of property without any restriction on their rights as owners to transfer, encumber, lease, will, or have their heirs inherit their interest in the property.

Tenancy in common results from a designation as such in a deed and is created whenever real property is conveyed to two or more persons with no designation as to the type of co-ownership intended.

Tenants in common own individual, undivided interests. These interests need not be equal in quantity and duration. These interests may be acquired at different times with different instruments and may be sold or willed separately. Each tenant in common holds a separate deed to their interest. Because of this, there is no right of survivorship.

The tenant in common co-owners have only one unity: possession.

This equal right to the possession provision allows each to use the total property without interference from the others.

Joint Tenancy

The law establishes specific requirements for **joint tenancy**. Among the requirements are four unities—time, title, interest, and possession. All parties must be created joint tenants at the same time by one instrument conveying the title. All must enjoy the same proportional interest, and all enjoy equal rights to the possession of the property.

The right of survivorship is the distinguishing characteristic of a joint tenancy, with the idea that the whole title is vested in each of the tenants, and the one who dies simply drops out of the estate. The survivors do not take the property by inheritance because they already owned the whole. Joint tenants may not will their interests in the tenancy, although they may sell or otherwise dispose of their interests before death.

If there are only two people in a joint tenancy and one of them conveys his/her interest to a third party, this breaks the joint tenancy and makes both new and old owners tenants in common. If three or more people hold title as joint tenancy and one conveys interest, the grantee becomes a tenant in common with the others who remain in joint tenancy as to each other.

A joint tenant may execute a deed of trust against his/her interest, or a judgment lien may be placed against it. This does not terminate the joint tenancy, but in the case of the joint tenant's death before he or she has repaid the loan or satisfied the judgment, the survivors of the joint tenancy are not liable to the creditors of the deceased since, at death, the property belongs to the joint tenancy survivors, not the heirs of the deceased.

Except for the right of survivorship, the rights and obligations of joint tenants are the same as among tenants in common as to accountability, contributions toward expenses, and rights of possession.

The creation of a joint tenancy must be by deed or will. It may be created by a sole owner deeding the property to the owner and others, by tenants in common deeding to themselves, or by tenants-in-common deeding to themselves and others.

In whatever way created, there must be only one deed and the words "As joint tenants" or "In joint tenancy" must appear in the deed to establish this estate.

The major advantage of holding property "as joint tenants" is the simplicity of clearing title upon the death of one joint tenant. Termination by death is automatic, and the survivor becomes the owner at that time; however, for title record purposes, the survivor either must record a court decree establishing the fact of death or an "affidavit of death of a joint tenant(s)" together with a death certificate.

Contrary to popular belief, there are disadvantages to holding in joint tenancy that could be extremely dangerous in many situations. These include the fact that joint tenants cannot dispose of their interest by will. Either party can sever the joint tenancy by transfer to a third party without the consent of the other, and the surviving joint tenant must trace at least one half of his/her cost basis for income tax purposes back to the time of the original joint acquisition.

In both tenancy in common and joint tenancy, any one of the tenants, except for spouses with community property, may force the sale of the property by filing an action in court called a Partition Action.

Termination of a joint tenancy occurs by death, transfer, agreement, or by partition action.

It might be important to mention here that it is neither the right nor the duty of a broker to advise a customer as to the way the customer should take title. This is a matter for an attorney who, in possession of all the facts, can give proper advice.

Community Property

The community property laws of California and certain other states are derived from Spanish law. These laws came to be included in California law because of the Treaty of Guadalupe Hidalgo made with Mexico in 1848. They are part of the Civil Code of California and have been amended many times throughout the course of history.

Community property basically consists of equal interests in all property acquired by spouses during a valid marriage, other than specific types of separate property. Under the Civil Code of California as interpreted by the courts, the excluded separate property of the spouses consists of:

- All property owned by either spouse before marriage.
- All property acquired by either spouse during marriage by gift or inheritance (bequest, devise, or descent).
- All rents, issues, and profits of such separate property, as well as other property acquired with the proceeds from the sale of separate property. For instance, if a wife owned a duplex prior to marriage, the rents from the duplex would remain her separate property. If she sold the duplex and bought common stock, the stock and dividends would be her separate property, and separate records should be maintained, lest it be so commingled with the community property as to be indistinguishable. Very often, spouses deliberately or casually allow their separate property to merge with community property in keeping with their intentions.
- Earnings and accumulations of one spouse and of his/her minor children who are in that spouse's custody or living with that spouse separately and apart from the other spouse.
- Earnings and accumulations of each party after rendition of a court decree of separate maintenance.
- Personal injury awards when the injury is caused by the opposite spouse.

Two spouses taking title in their names by a deed describing them as spouses would take title in community property. If they wish to take title as joint tenants, the deed must so describe them. For the division of property on dissolution of marriage or legal separation, any property acquired by the spouses during marriage as joint tenants, or by any other form of title holding, is the community property of the parties.

Each spouse is given equal management and control of the community property. An exception to equal management and control exists where one of the spouses manages a community property business. This spouse has sole management and control of the business. Community property is liable for the debts of either spouse contracted for after marriage. For debts contracted prior to marriage, community property is liable only for those debts that benefited both spouses and were supported by both spouses.

Neither spouse may make a gift without the consent of the other. Neither spouse may encumber the furniture, furnishings, or fittings of the home, or the clothing of the other spouse or minor children without the written consent of the other spouse. Both must sign in the conveyance, encumbrance, or leasing for more than a year of community real property.

Each spouse has the right to dispose of his/her one half of the community property by will. If either spouse dies intestate (without a will), the survivor succeeds to the decedent's half of interest.

The law that governs the distribution of property after dissolution of marriage is contained in the Civil Code.

Tenancy in Partnership

Frequently, two or more persons will enter into a formal type of business association known as a partnership. Basically, the partners will unite a certain amount of their property, labor, or skill in some joint and lawful enterprise, agreeing to share the expenses and the profits. A partnership is not a corporation, nor is it merely a "joint venture," but rather a formal association of the partners to carry on a specific business.

The **partnership** may be one of two kinds: A general partnership or a limited partnership. A general partnership may be entered verbally; however, it is highly advisable that it be in writing. A limited partnership must be in writing and the articles of partnership must be filed with the Secretary of State of California and with the county clerk of the county where the business operates. The usual form of a partnership agreement is called articles of partnership. All general partners are personally liable to third parties for all partnership debts. This would mean that each partner is liable for the entire obligations of the partnership, even though they may be greater than either partner's original investment in the business.

A limited partner, on the other hand, is not liable for any amount other than the sum the partner has invested in the partnership. Syndications usually take the form of a limited partnership because of this fact. Because of this insulated liability, the limited partner may take no part in the management or operation of the business and the limited partner's name may not be used in connection with the business.

The Law of Agency applies to a partnership since each partner acts as the agent of the other partners and may not take advantage of his/her position at the expense of the partnership. In dealing with partnership property, a partner must act for the benefit of the partnership. Any advantage secured only for one partner would be considered fraudulent.

A partnership may own real property. Each partner is a co-owner with the other partners of a specific property, holding such title as a tenant in partnership. The title to the real property may be held in the names of all the partners or under a fictitious firm name, commonly called a DBA (doing business as). A fictitious business name is good for five years from the last day of the year in which it was recorded.

Each partner has equal rights to the possession of the entire partnership property for partnership purposes. No partner can sell, lease, or encumber his/her interest unless all partners join in the transaction. This rule applies both to specific property owned by the partnership and to the partner's interest in the partnership as a business.

If a partner is married, the partner's interest in partnership property is not community property and the consent of the spouse is not required to transfer title. However, the spouse would have a community property interest in the partner's interest in the partnership as a whole. The partner's interest is not subject to attachment or execution, except on a claim against the partnership.

The **Statute of Frauds** lists those contracts that must be in writing if either of the parties finds it necessary to take a dispute to court. A partnership agreement is not included in the list and is therefore not required to be in writing.

A partner may not will any interest in specific partnership property. Upon the death of a partner, a form of survivorship arises in the surviving partners. This right of survivorship is only for controlling the business until the partnership can be dissolved and the interest of the deceased partner is distributed to his/her heirs.

A partnership may be terminated voluntarily by the partners or, failing mutual agreement, by proper court proceedings.

Easements

An **easement** may be defined as "the right to use land owned by another person for a specific purpose." As such, it is an encumbrance on the property on which it is placed. Easements may be for a definite or indefinite duration. A lease is an exclusive right, an easement is usually a non exclusive right to use. The use may be varied, extending from a right of way to gain access to land owned by the holder of the easement or the right to have floodwater flow across a person's land, to rights to take minerals from the land of another, or to use such land for public streets, or for installing public utilities. To be valid, an easement granted for ingress and egress does not need to be specifically located in the deed.

Simple permissive use never grants, transfers, or creates an easement, no matter how many years would be involved.

If the easement is an exclusive easement, only the holder of the easement may use it.

Appurtenant Easements

Whatever the reason for its existence, an easement creates a servitude on the land, meaning that it serves the purposes of another who is not the owner of the land. Thus, the land upon which the easement is imposed is known legally as the servient tenement, while the land that is benefited by the easement is called the dominant tenement. Easements are considered appurtenant to the dominant tenement and pass automatically upon transfer so that subsequent owners of the **dominant tenement** also have the rights granted under the easement. Buyers of the **servient tenement** buy the property subject to the easement.

Easements in Gross

Easements that are not appurtenant to a parcel of land or dominant tenement are known technically as **easements in gross**. In such instances, there is no dominant tenement. An example would be those rights given to utility companies to erect poles or string wires upon private land.

Unless it is specifically described to be exclusive, an easement does not prevent the owner of the land from using that portion covered by the easement, so long as the owner does not interfere with the use for which the easement exists. For instance, if the easement is for road purposes, the owner may not build a structure upon that part of the land.

Easements may come into existence in a number of ways. Seven general methods by which they are created are by grant, dedication, necessity, prescription, implication, condemnation, and reservation.

Grant - Easements created by grant must comply with the general requirements of a deed and may arise either by express grant, giving the right of use, or by express reservation, whereby the grantor of the land reserves the use of a portion of the land being transferred for the grantor. The grant of an easement or easements is often included in the provisions of a deed. The deed must, like the description of the property, properly describe the location of the easement. A deed to an unlocated easement is valid. The fact that an easement is unlocated may give rise to legal questions; however, if it is recorded, it is a valid easement.

Recording of an easement is not necessary to give notice to a subsequent purchaser.

Dedication - Most often, easements by dedication are created by subdividers when obtaining approval from local government agencies.

Necessity - Easements by necessity are generally recognized whenever a transfer occurs that truly “land locks” a parcel of land, as when a grantor conveys an area entirely surrounded by the grantor’s remaining land or that of adjoining owners, so that the new owner has no access to the grantor’s property without the easement. Both the dominant tenement and the servient tenement must have had a private common owner at one time. Though no actual easement is created by written document, use becomes the identifying factor.

Prescription - An easement may also be acquired by prescription, essentially as one would acquire land by adverse possession that is by open and notorious use for a period of five years without protest or recorded notice of consent. However, payment of taxes is not required. This type of easement may be lost by mere non use continuing over a five-year period.

An easement gained by prescription is usually not recorded because the owner would not normally acknowledge the instrument.

Note that the use must be adverse to the owner. If the owner has given permission to use the land, the essential element of adverse use does not exist and an easement may not be obtained. Generally, the permissive use cannot ripen into an easement.

Legislation prevents the acquiring of an easement by prescription if the owner posts the property as prescribed. The law states, in effect, that if the land is posted at each entrance or at intervals of no more than 200 feet by a sign stating “Right to pass over by permission subject to control of owner, Civil Code 1008,” an easement may not be obtained.

Implication - Easements by implication are recognized when land in one ownership is divided and, at the time of division, one portion is being used for the benefit of the other portion. Sewer laterals, gas lines, etc., give illustration. Another type of easement by implication arises when land is sold with reference to a plat map showing streets, walks, etc. The purchaser of the land then gains an easement over such delineated ways.

Condemnation - Usually, an easement is created in condemnation proceedings when some public utility or governmental authority condemns property for street or public utility purposes. This form of easement is usually an easement in gross and would become an encumbrance on all properties involved.

Reservation - When a grantor of title to property keeps an easement for some specific purpose across the land transferred, the grantor has created an easement by reservation. The grantor reserves or excepts it from the title the grantor has transferred.

Termination of Easements

Easements by prescription are the only kind that are lost by non-use, except those created by dedication where it is expressly stated that if they are not used for the purposes for which they were dedicated, the use of the land shall revert to the owner.

All other easements are terminated only by express written release (quitclaim deed) from the holder of the easement or by a merger of the dominant and servient tenements. Those granting use of a property for public utilities, rights-of-way, etc., generally remain in force indefinitely. Often, property owners are not aware of easements and restrictions that are recorded and are dismayed to find that the gas company, for instance, may come in and dig up their lawns to lay new pipes.

License

A license is a revocable right for a person to use real property belonging to another. It is personal to the holder and cannot be assigned by the holder without the consent of the owner of the real property affected. A license, as a general rule, is synonymous with an invitation.

Capacity to Deal with Real Property - Minors

Minors are all persons under 18 years of age. Although minors may acquire title to property at any time since the law presumes that they accept it, they may not dispose of property except as provided by law.

Everyone 18 years of age or over has the rights of an adult, including the right to vote, make enforceable contracts, marry, etc. The only prohibitions affecting an 18 to 21-year-old are those regarding alcoholic beverages and tobacco.

California law now identifies emancipated minors. Such minors are persons under the age of 18 years who:

- have entered into a valid marriage, even if the marriage has been dissolved
- are on active duty with any of the armed forces of the United States of America
- have received a declaration of emancipation by petitioning the superior court of the county where they reside.

Brokers, in their dealings with minors, must proceed cautiously and judiciously and very often should seek the counsel of an attorney before proceeding with such clients.

Emancipated minors are considered over the age of majority, among other things, for the purposes of:

- entering into a binding contract
- establishing their own residence
- buying and selling real property.

Minors may petition the superior court of the county in which they reside for a declaration of emancipation. If granted, this declaration of emancipation is filed with the county clerk. This declaration of emancipation is to be accepted as conclusive evidence that the minors are, in fact, emancipated. The parents of minors can sometimes successfully object to the issuance of such a declaration.

Anyone dealing with minors does so at their own peril. In a real estate transaction, it would be the real estate broker's responsibility to determine the proper status of the buyer or the seller. Generally, the safest method of dealing with minors is to do so through a court appointed guardian, unless it has been determined that the minors have been legally emancipated. The fact that a client is a minor, whether emancipated or not, is worthy of reporting to the escrow company to enable the title company to do proper research and to provide protection within their policy.

Convicts

Convicts do not forfeit their property. They may acquire property by gift, inheritance, or will, under certain conditions, and they may convey their property or acquire property through conveyance.

Under Conservatorship (Incompetent)

A person who has been officially adjudged to be incompetent is incapable of entering into contracts concerning any matter and such contract would be void. Persons of unsound mind but not entirely without understanding, and whose capacity has not been officially determined, may enter into contracts, but such contracts and transfers are voidable upon proof of incapacity. As with minors, incompetents may acquire property (such as by gift or inheritance) but cannot dispose of it except through proper procedure by appointment of a conservator whose actions are subject to court approval.

Corporations

A corporation is a legal person. It is an entity created by law having a personality and existence distinct and apart from that of the shareholders. Property owned by a corporation is held in severalty—that is, by “one” legal person, the corporation. Since the government is considered as one entity, it, like a corporation, holds title in severalty. While the shareholders own the corporation, the continuation of its business is not affected by the death of any one of them since a corporation is said to have the capacity for perpetual succession; therefore, “it does not die.” It follows, logically, that a corporation cannot hold property in joint tenancy because it would always outlive an individual.

Corporations have the capacity to issue bonds, collateralized by the real property they own, to raise capital above that which, under ordinary circumstances, would be done through trust deed financing.

The details of forming a corporation are a matter for an attorney. Articles of Incorporation must be filed with the Secretary of State and a corporation franchise secured. Permission to issue stock is received from the Corporations Commissioner. Foreign corporations (those outside of the state) must register with the Corporations Commissioner before they can do business in California. Officers of the corporation do not have the power to contract on behalf of the corporation without authorization of the board of directors that has the governing power.

The members of the board of directors are elected by the stockholders. The officers are elected by the board of directors, but they cannot enter into any contracts on behalf of the corporation without the express consent of the directors. Such decision is usually in the form of a resolution authorizing certain officers to deal with the corporate property. It is included in the minutes of a meeting legally called, at which a quorum was present.

To protect his/her principal, a broker, in dealing with a corporation, will request a certified copy of the resolution from the secretary of the corporation, disclosing the corporate officers with whom one can negotiate safely. It is not safe to assume that because an official seal is imprinted on a document, the person signing it has proper authority. The seal has no bearing on the validity of such instrument.

Years ago, the seal represented real authority and was required on corporation documents as evidence that they were executed properly. Today, a seal is said to give only evidentiary value that the document was executed in a proper manner. A document executed by the board of directors would be valid without the seal.

Small family-owned corporations are sometimes created as Chapter S corporations. This feature allows all the protections of a corporation except that the income is not double taxed. It is taxed as individual income to the stockholders.

The most important characteristics of a corporation are:

- ▢ Its separate capacity to deal with property, independent from members
- ▢ Centralized control in a board of directors
- ▢ Liability of shareholders limited to the amount of their investment
- ▢ Freely transferable shares
- ▢ Continued existence, regardless of death or retirement of its shareholders
- ▢ Income is subject to corporate tax first, and, if given as dividends to the shareholders, to individual income tax.

Corporations, therefore, have net income to the shareholders that is double taxed.

Partnerships

In the transfer of title to partnership property, the problem arises frequently as to the necessary signatures required. This is especially true when the title to the property is held under a fictitious firm name rather than in the names of the individual partners.

The signatures of all partners are required. In the case where the title to the partnership property is held in the name of the individual partners, this general rule is applicable.

Where the partnership is using a fictitious firm name and the title to the property is held under that name, the names of the partners will have to be determined. For this purpose, a partnership would record a Statement of Partnership in the county recorder's office. This would disclose the names of the partners and, therefore, the signatures required.

Where there are many partners, it is possible that one or more of them would be authorized to act on behalf of the partnership. In that case, only the authorized signatures would be required. Such authority should be in writing.

If a partner is married, the question may arise as to whether the spouse's signature is required. Such signature would be required where the title is held in the names of the individual partners. Where title is held under a fictitious firm name, the spouse's signature is not required; however, as a matter of practice, lending institutions and title companies will insist that the spouse at least sign a consent to the transaction.

Though it is a tax reporting entity and must file an income tax report, for income tax purposes, a partnership is not treated as a separate entity. Each partner must report their share of income and expenses on their individual tax returns.

Unincorporated Groups

Nearly every adult has, at one time or another, belonged to a group banded together for some charitable, educational, civic, religious, social or profit venture, in an informal manner.

Sometimes the organization grows to the point where it is deemed necessary to acquire real property, embarking upon what the law terms a joint venture.

Since a definite grantee is essential to a valid deed, and since the group usually does not wish to enter into a partnership or form a corporation for their venture, it becomes apparent that unless certain steps are taken, every member of the group must sign any purchase agreement before there can be a binding contract; in addition, should they wish to sell the property so purchased, not only must the members themselves sign, but their spouses, if any, must also sign.

This, of course, is a great disadvantage since it is often difficult to get all members of such a group to agree specifically on any one subject, but if so handled, there is nothing to prevent one member of the group from disposing of his undivided share without the consent of the others. If no specific fund is set up to take care of taxes, insurance, etc., it might be difficult to collect the contribution of each member.

It would be correct, in the case of such informal associations, to include in their charter and bylaws a provision for the appointment of a specific individual or individuals to act as trustee(s) for the group. This would not be as common in the case of fraternal societies and labor unions. because of their more formal organization would require multiple signers after a vote of membrs or a board of directors decision.

In making a sale of property held by such a group, the prudent broker will inspect the charter and bylaws of the organization to know by whom the property may be transferred, properly and legally.

Administrators and Executors

Upon the death of a person, the title of all his/her property, both real and personal, is transferred to the persons entitled thereto under the will of the deceased or by the law of intestate succession. The only exception is property held under joint tenancy. The control of the title comes under the jurisdiction of the Probate Department of the Superior Court. The court will appoint an administrator or an administratrix. Where a will exists, the deceased may have appointed an **executor** or executrix in his/her will for conserving the estate, paying all debts, and distributing the property.

The probate code limits the capacity of the administrator or executor to enter into contracts or conveyances. Before they may bind the estate, they must have approval of the probate court. This rule applies also to listing any probate property with a real estate broker. It is possible for the court to approve an exclusive real estate listing for a period not to exceed 90 days. In the event that the listing is approved, the broker is required to procure a purchase for at least 90% of the appraised value and to secure court confirmation of the sale before the court would order payment of any commission. The court sets the commission rate to be received by the real estate broker.

Once an offer has been accepted by the administrator or executor, it is subject to confirmation by the court and a hearing date is set for such confirmation. This hearing date must be published in a newspaper of general circulation. At the time of the hearing, the law provides that any person wishing to enter an over bid on the property may do so. The first over bid must be in an amount equal to the original bid, plus 10% of the first \$10,000 and 5% of any amount over \$10,000. Thus, if the original bid is for \$36,000, the first over bid must be at least \$38,300 ($\$36,000 + \$1,000$ (10% of \$10,000) + \$1,300 (5% of \$26,000)). Thereafter, additional over bids may be in any increased amount established by the court. The court may confirm whichever bid is for the best interest of the estate.

The court also gives serious attention to any sale of the deceased's property within one year prior to death. Involuntary sales are discarded. Low-priced voluntary sales may be seen as a way of avoiding inheritance tax laws or the influence of relatives on an incompetent dying person.

It is well established in law that the relatives and business associates of a seriously ill person may take advantage of that person by forcing the sale of property, prior to death, at a less-than-value price. The court may set aside such a sale.

In the event that the original bidder was represented by a broker and the successful over bidder was also represented by a broker, the court would probably order a division of the commission.

Major steps in the procedure for probate are:

- ▣ A petition for probate (or for Letters of Administration, if there is no will) is filed;
- ▣ A hearing is held, appointing a representative to handle the estate; an executor or administrator is named in the will;
- ▣ A notice is published to creditors, giving them four months in which to file their claims;
- ▣ The estate is inventoried and appraised;
- ▣ Finally, a petition is filed with the court to approve distribution of remaining assets to the proper heirs and devisees.

During administration, the appointed representative may sell the estate property, subject to court approval.

Any personal representative of a deceased person who wishes to administer the estate of a deceased person under The Independent Administration of Estates Act may seek the authority to do so by petitioning the court in an appropriate manner. Upon gaining such authority, the executor or administrator can handle most matters on behalf of the estate without prior court approval.

However, prior to any sale or exchange of assets of the estate, the representative must give notice of any proposed action by mail to all parties interested in the estate. If any of the affected persons should object to the action proposed by the representative, they can ask the

court for a restraining order to keep the representative from taking action. If the objection is honored by the court, then the representative can only pursue the proposed action with the prior approval of the court.

Under this law, the representative can also enter into an exclusive listing with a licensed real estate broker for a term not to exceed 90 days without court approval or subsequent court confirmation, and without notice to any interested persons, when it is necessary and advantageous to the estate to do so.

Inheritance

Property “rights” in the property of a deceased person can be classified in three ways: title, possession, and control.

At the time of death, title to the deceased person’s property passes directly to the deceased person’s heirs or to those named as beneficiaries in the deceased person’s will. In theory then, the successors in interest who receive title in such a circumstance may convey or encumber the title.

The title received upon the decedent’s passing is not immediately marketable or insurable with title insurance since the Probate Code provides that upon death, all property of the deceased person is subject to the possession of the executor or administrator until the matter of administration of the estate is completed. There are some exceptions, which include:

- **Community Property:** upon the death, intestate, of the husband or the wife, vests in the surviving spouse without any administration (probate)
- **Property held in joint tenancy:** Estates composed entirely of personal property of little value would vest in the surviving spouse in the same manner.

Legal title is also subject to the control of the probate court for purposes of determining and liquidating creditors’ claims against the estate and for the purpose of identifying the ultimate beneficiaries of the estate. The same exceptions mentioned above apply to the matter of court control.

Escheat

The State may acquire the property of persons dying without a will and without heirs, or with only alien heirs who do not reside in this country and who are citizens of a country that does not allow United States citizens to inherit property located in that country. The title is said to “revert to the state.”

Wills

Property accumulated during life may be disposed to designated beneficiaries upon death. The instrument to achieve this disposition is called a will. The instrument becomes effective at death.

There are two types of wills permitted by California law. They are a witnessed will and a holographic will.

The law now establishes that a will—which is not a witnessed will—is valid as a holographic will, whether or not witnessed, if the signature and the material provisions are in the handwriting of the testator. If there is no statement as to the date the will was made, it may be declared invalid to the extent that it is inconsistent with another will made by the same person. Also, if it can be shown that the testator lacked capacity at the time of its creation, it may be set aside by the court.

If a person dies without leaving a will, the law provides for the disposition of the estate of the deceased. This is called **intestate succession**. Many special rules are found in the law that deal with this circumstance. These rules depend upon the character of the property and the relationship of the next of kin or the heirs of the deceased person.

Certain words and phrases occur with regard to the willing of property. The common beginning to a will states, “Being of sound mind, I hereby devise and bequeath to my heirs and assigns, all of my real and personal property as follows...”

Other words used in wills are executor or executrix, referring to those who are appointed in the will to administrate the disposition of the estate. Additional terms:

Ambulatory: a changeable will or will subject to change

Codicil: an addition or supplement altering a will

Legacy: personal property received by will

Lineal: pertains to direct line of descendants

Devise: to give real property by will

Devisee: one who receives real property under a will

Bequeath: to give personal property by will

Separate Property - No Will

With respect to the separate property of a decedent spouse, in the simplest cases where there is a surviving spouse and there are no children or descendants of children, it is divided one half to the spouse and one half to the parents of the deceased. Again, with separate property where there is a surviving spouse and one child, it is divided one half to the spouse and one half to the child. But, where there is a surviving spouse and two or more children, the separate property would be divided one-third to the spouse and two thirds divided equally among whatever number of surviving children there are. If there is no surviving spouse, the separate property of the deceased would all go to the children equally; if there are no children, it would go to the parents of the deceased person.

Probate of Community Property

When either spouse dies intestate or dies testate and leaves all or part of his/her interest in the community property to the survivor, such property passes to the surviving spouse without the necessity of probate.

However, where the decedent dies testate and leaves all or part of his/her interest in the community property to someone other than the surviving spouse, or if the will contains a trust, the decedent's interest in the community property disposed to someone other than the surviving spouse and that placed into trust are expressly made subject to probate.

With respect to community real property where record title is in the name of the survivor or the survivor and any person other than the decedent, 40 days after death, the surviving spouse is granted full power to sell, lease, mortgage, or otherwise deal with such community property, provided notice of a claim to such property under the will of the decedent has not been recorded in the county in which the property is located.

The law specifically declares the community property to be liable for all valid and enforceable debts chargeable against the community property existing at the time of death.

The surviving spouse is made personally liable for the unsecured debts of the decedent to the extent of the value of the interest of the decedent in the community property passing to the survivor without probate. These debts may be enforced against the survivor in the same manner as they could have been enforced against the decedent, had death not occurred.

The law establishes a procedure whereby a surviving spouse may petition the court for an order declaring all or a specified portion of the estate is community property passing to the survivor without probate. Similarly, any person interested in the estate of the decedent may petition, within 120 days following death, for an order directing probate of the estate claiming that all or a portion of the estate is not community property passing to the surviving spouse.

In either proceeding, where there is a finding that all the property is community property passing to the surviving spouse, the court must issue an order confirming it as such and declaring that no probate is necessary. Where the court finds that all or a portion of the estate is not community property passing to the surviving spouse, the confirmation order must be directed only to that community property that passes to the surviving spouse with the remainder of the estate ordered into probate.

Upon becoming final, a confirmation order is expressly declared to be conclusive on all persons interested in the estate, and the subsequent sale or encumbrance of any community property that is the subject of a confirmation order exempts such property from probate in the estate of the decedent for any purpose.

Homesteads

Because of the importance of the home to the welfare of the family and to the State, our legislators have passed laws that give special protection to homeowners against loss of the home because of debt.

Ordinarily, if one owes a debt and does not pay it, the creditor may sue and obtain a court judgment that, when recorded, becomes a lien on the real property of the debtor, and the court will, if the judgment is not paid, issue an order to have the property sold to raise money to pay the debt.

To provide against loss of the home because of such action, the law permits a person to protect his/her home by recording a declaration of homestead that will exempt that property from any after-secured judgment or after recorded involuntary lien (except mechanics' liens) and as a specific provision of certain California Civil Code sections dealing with condominium assessments.

If the homestead declaration is filed by the judgment debtor, an individual owner of dwelling in which he resides is protected from a Writ of Execution (a court order to have the property sold after judgment) to the extent of \$75,000 of equity. You may exempt up to \$100,000 if you live with a family member; \$175,000 if you are 65 or older, or physically or mentally disabled; \$175,000 if 55 or older, single, and earn a gross annual income under \$25,000 or are married and earn a gross annual income under \$35,000 and creditors seek to force the sale of your home. If you are married but separated, you may claim the homestead exemption in community property occupied by your spouse. Only one homestead at a time is valid on a given residence.

The homestead does not prevent a creditor from forcing the sale of the homesteaded residence if the equity in the property exceeds the homesteaded amount. The first monies from the sale would satisfy the court costs, then trust deeds or mortgage liens, then the debtors (home-owners) exemption. The balance would go to the creditors. If there is excess, it would go to the homesteader.

Homestead means the principal dwelling:

- in which the judgment debtor or spouse resided on the date that a judgment creditor's lien attached to the dwelling, and
- in which either or both resided continuously until the date of the court determination that the dwelling is a homestead.

The dwelling may consist of community or separate property held in joint tenancy or tenants-in-common and may be a condominium, planned development, stock cooperative, community apartment project, or a lease for 30 years or longer. It may also be an apartment in an apartment house that is occupied by the owner of the entire building.

NOTE: Only the rooms actually occupied will constitute the homestead.

A Declaration of Homestead is of no effect until it is recorded.

The property selected by married persons for declaring a homestead may be either community property or one spouse's separate property. One spouse may declare a homestead if the other spouse does not, but must declare that it is homesteaded for their joint benefit. Other members of a "family unit" may select the homestead from any property they own.

To terminate the homestead, a Declaration of Abandonment may be prepared and recorded. The homestead is also broken if the property is sold to others or transferred to others by foreclosure of the property under mortgage or trust deed. Destruction by fire does not indicate abandonment.

The protection afforded by a Declaration of Homestead does not defeat:

- ▢ Mortgages and trust deeds executed and acknowledged by two spouses or an unmarried claimant
- ▢ Mortgages and trust deeds recorded before the declaration was recorded
- ▢ Mechanics' liens
- ▢ Judgments that became liens before the declaration was recorded
- ▢ Federal tax liens
- ▢ State tax liens.

A homestead does not offer any protection from a lien arising under an agreement, covenant, or restriction between or binding upon owners of a title, interest or estate in a condominium, planned development, stock cooperative, or community apartment project.

The homestead only protects against judgments that become effective after the homestead has been recorded.

The California Supreme Court has ruled in one case that a Declaration of Homestead recorded before judgment defeats a prior recorded attachment lien.

If the property is sold by the homesteader or under a court order, the homesteader is protected in exemption for six (6) months to allow time to acquire another dwelling and homestead it.

Statute of Frauds

Most contracts that, by statute, are required to be in writing are referred to as coming under the Statute of Frauds. The **Statute of Frauds** was created in England and became part of the English Common Law; thereafter, it was introduced into this country and embodied in our statutes. The purpose, of course, was to prevent injury from perjury, forgery, and dishonest conduct on the part of people dealing in certain types of property.

The Statute of Frauds provides that certain contracts must be in writing to be enforceable. Most contracts involving the sale and leasing of real estate fall into this classification. One of the exceptions is a lease for a term of one year or less, which need not be in writing. In this case, the law presumes a month-to-month tenancy and the burden is upon the renter to prove otherwise.

A broker's authorization to sell real property must be in writing or the broker cannot sue for a commission. If the contract is signed by one party but is ratified by the conclusion of the sale, the court would most probably rule that the contract was valid.

A trust deed or lien that is recorded must be in writing, and if a purchase of a property assumes an existing trust deed, the assumption must be in writing.

Contracts for the sale of a business need not be in writing to be enforceable. They are evidenced by the actions of the buyer and seller.

Provisions of the Statute

The Statute provides that certain contracts are invalid unless the agreement or some note or memorandum thereof is in writing and is signed by the parties. Contracts that are required to be in writing are:

- ▢ An agreement that, by its terms, is not to be performed within a year from the making thereof.
- ▢ A special promise to answer for the debt, default, or miscarriage of another.
- ▢ An agreement made upon consideration of marriage other than a mutual promise to marry.
- ▢ An agreement for the leasing for a period longer than one year, or for the sale of real property, or of an interest therein; and such agreement, if made by an agent of the party sought to be charged, is invalid unless the authority of the agent is in writing subscribed by the party to be charged.
- ▢ An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate; an agreement to lease real estate for a period longer than one year; an agreement to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where such lease is for a period longer than one year. To qualify, all agreements must be for compensation or a commission.
- ▢ An agreement that, by its terms, is not to be performed during the lifetime of the promisor, or an agreement to devise or bequeath any property, or to make any provisions for any person by will.
- ▢ An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of said indebtedness by the purchaser is specifically provided for in the conveyance of such property.

It should be noted from the reading of the provisions of this Statute that a contract employing a broker to find a purchaser, to affect an exchange, or lease property for more than a year, or a management contract which extends beyond the period of a year, must be in writing to be enforceable against the principal. Such a contract would also have to be in writing to give the agent the ability to bring an action in court for payment of a commission.

On the other hand, a contract to negotiate a loan or lease for one year or less need not be in writing to be enforced by the courts.

If a real estate broker works under a verbal real property sales listing, it is not an illegal contract, but if the seller refuses to pay the commission, there is no way the broker may enforce the broker's right to collect. If the seller keeps his/her verbal promise to pay, the broker has the right to keep the commission. The use of the Statute of Frauds to enforce all oral agreements that have been executed is not valid. If a party to an oral agreement, after the contract is complete and all terms met, at a later date decides to rescind the agreement, the Statute cannot be used.

An executed purchase agreement, exchange agreement, and land contract are contracts for the sale of real property, or an interest therein, and must, by provisions of this Statute, be in writing to be enforceable.

The Statute of Frauds has the purpose of preventing a suit on a contract that is oral when it is required to be in writing. It cannot be used as a defense after the contract has been performed (executed). The courts have also held that an oral listing creates a principal agent fiduciary relationship, even though the agent has no enforceable contractual claim for his/her commission.

Statute of Limitations

Laches is a doctrine based upon the inequity of permitting a claim to be enforced because the claimant has delayed too long in pursuing the claimant's rights. It is upon this doctrine of laches that the statute of limitations is based, allowing given time periods in which to bring court actions.

This statute prescribes time limits within which legal action may be taken to gain something that is due. In other words, the lawsuit seeking the remedy must be brought within a specified period after the right has accrued.

Actions That Must Be Brought Within 90 Days

Civil actions for the recovery or conversion of personal property such as trunks, suitcases, or baggage alleged to have been left at a hotel, boarding house, lodging house, furnished apartment house, or furnished court, shall be commenced within 90 days from and after the departure of the owner of the personal property.

Within Six Months

An action against an officer, or officer de facto: To recover any goods, wares, merchandise or other property seized by any such officer in such official capacity as tax collector, or to recover the price or value of any such goods or other personal property, as well as for damage done to any person or property in making such seizure.

Within One Year

An action upon a statute for a penalty or a forfeiture when the action is given to an individual or to an individual and the State, except when the statute imposing it prescribes a different limitation.

An action upon a statute, upon an undertaking in criminal action, or a forfeiture or penalty to the State.

An action for libel, slander, assault, battery, false imprisonment, or seduction; for injury to or for the death of one caused by the wrongful act or neglect of another; or by a depositor against a bank for the payment of a forged or raised check.

Within Two Years

An action upon a contract, obligation, or liability not founded upon an instrument in writing.

An action founded upon a contract, obligation, or liability evidenced by a certificate or abstract or guarantee of title of real property.

An action by a policy of title insurance. All actions provide that the cause of action of such contract shall not be deemed to have accrued until the discovery of the loss or damage suffered by the aggrieved party thereunder.

Within Three Years

An action upon a liability created by statute, other than a liability for a penalty or forfeiture.

An action for trespass upon or injury to real property; an action for taking, detaining, or injuring any goods or chattels, including actions for the recovery of specific personal property.

An action for the relief on the ground of fraud or mistake. Such cause of action is not deemed to have accrued until the discovery by the injured party of the facts constituting the fraud or mistake.

Within Four Years

An action upon any contract, obligation, or liability founded upon an instrument in writing.

An action to recover:

- upon a book account, whether consisting of one or more entries
- upon an account stated
- a balance due upon a mutual open or current account, provided that where an account stated is based upon an account of one item, the time shall begin to run from the date of said item, and where an account stated is based upon more than one item, the time shall begin to run from the time or date of the last item.

Within Five Years

An action for mesne profits of real property. An action for the recovery of real property.

Within Ten Years

Only for an action upon a judgment or decree of any court of the United States or of any state within the United States.

Power of Attorney

A **power of attorney** is an acknowledged written instrument that authorizes one person to act for another in his/her stead.

The person who confers this right upon another is called the principal, and the person so authorized to act for the principal is called the **attorney-in-fact**.

The power of attorney may be either general or specific.

The general power of attorney permits the attorney-in-fact to do all acts for the principal.

The specific power of attorney permits the attorney-in-fact to do only those things that are specifically set forth in the instrument.

Any person capable of contracting may act as an attorney-in-fact. When the attorney-in-fact signs any instrument on behalf of the principal, the attorney-in-fact should sign according to this example: John Smith by William Jones, his attorney-in fact.

Due to title insurance requirements, the power of attorney should be recorded with the county recorder of the county in which the power conferred is to be used. If not recorded, the title company is unaware that the attorney-in-fact has the legal authority to act, if selling real estate.

The principal may revoke the power of attorney at any time by recording a properly acknowledged declaration revoking the authority in the same county in which the original agreement was recorded. The power of attorney is a personal service contract; therefore, the death of either party, or the incapacity of the principal, will terminate the agreement.

There are certain things an attorney-in-fact cannot do. The attorney-in-fact cannot give away the principal's property or convey or mortgage it without receiving adequate consideration. The attorney-in-fact cannot deed or mortgage the principal's property to himself, or otherwise use the property of the principal for the attorney-in-fact's own benefit. Such acts are voidable. The attorney-in-fact must have no interest adverse to the principal in order to act as an attorney-in-fact.

An attorney-in-fact is prohibited from mortgaging or conveying property upon which a homestead exemption has been recorded.

Chapter 5 Summary

Tenancy in common is a method for two or more persons to hold title to the same parcel of property without any restriction on their rights as owners to transfer, encumber, lease, will, or have their heirs inherit their interest in the property. Tenancy in common results from a designation in a deed and is also created whenever real property is conveyed to two or more persons with no designation as to the type of co-ownership intended.

Tenants in common own individual, undivided interests. These interests need not be equal in quantity and duration. These interests may be acquired at different times with different instruments and may be sold or willed separately. Each tenant in common holds a separate deed to their interest. Because of this, there is no right of survivorship.

Joint tenants may not will their interests in the tenancy, although they may sell or otherwise dispose of their interests before death. The major advantage of holding property as joint tenants is the simplicity of clearing title upon the death of one joint tenant. Termination by death is automatic and the survivor becomes the owner at that time

Community property basically consists of equal interests in all property acquired by spouses during a valid marriage, other than specific types of separate property. Neither spouse may make a gift without the consent of the other. Neither spouse may encumber the furniture, furnishings, or fittings of the home, or the clothing of the other spouse or minor children without the written consent of the other spouse. Both must sign to sale, convey, encumber, or lease if held as community property.

A **partnership** may be one of two kinds: A general partnership or a limited partnership. A general partnership may be entered verbally; however, it is highly advisable that it be in writing. A limited partnership must be in writing and the articles of partnership must be filed with the Secretary of State of California and with the county clerk of the county where the business operates. The usual form of a partnership agreement is called articles of partnership.

All general partners are personally liable to third parties for all partnership debts. This would mean that each partner is liable for the entire obligations of the partnership, even though the liability may be greater than either partner's original investment in the business.

A limited partner is not liable for any amount other than the sum the partner has invested in the partnership. Because of this insulated liability, the limited partner may take no part in the management or operation of the business and the limited partner's name may not be used in connection with the business.

An **easement** creates a servitude on the land, meaning that it serves the purposes of another who is not the owner of the land. Thus, the land upon which the easement is imposed is known legally as the **servient tenement**, while the land that is benefited by the easement is called the **dominant tenement**. Easements are considered appurtenant to the dominant tenement and pass automatically upon sale.

Where a will exists, the deceased may have appointed an **executor** or executrix in his/her will for conserving the estate, paying all debts, and distributing the property. The court may appoint an **administrator** when no will exists. A person receiving property from a will is called a **legatee**.

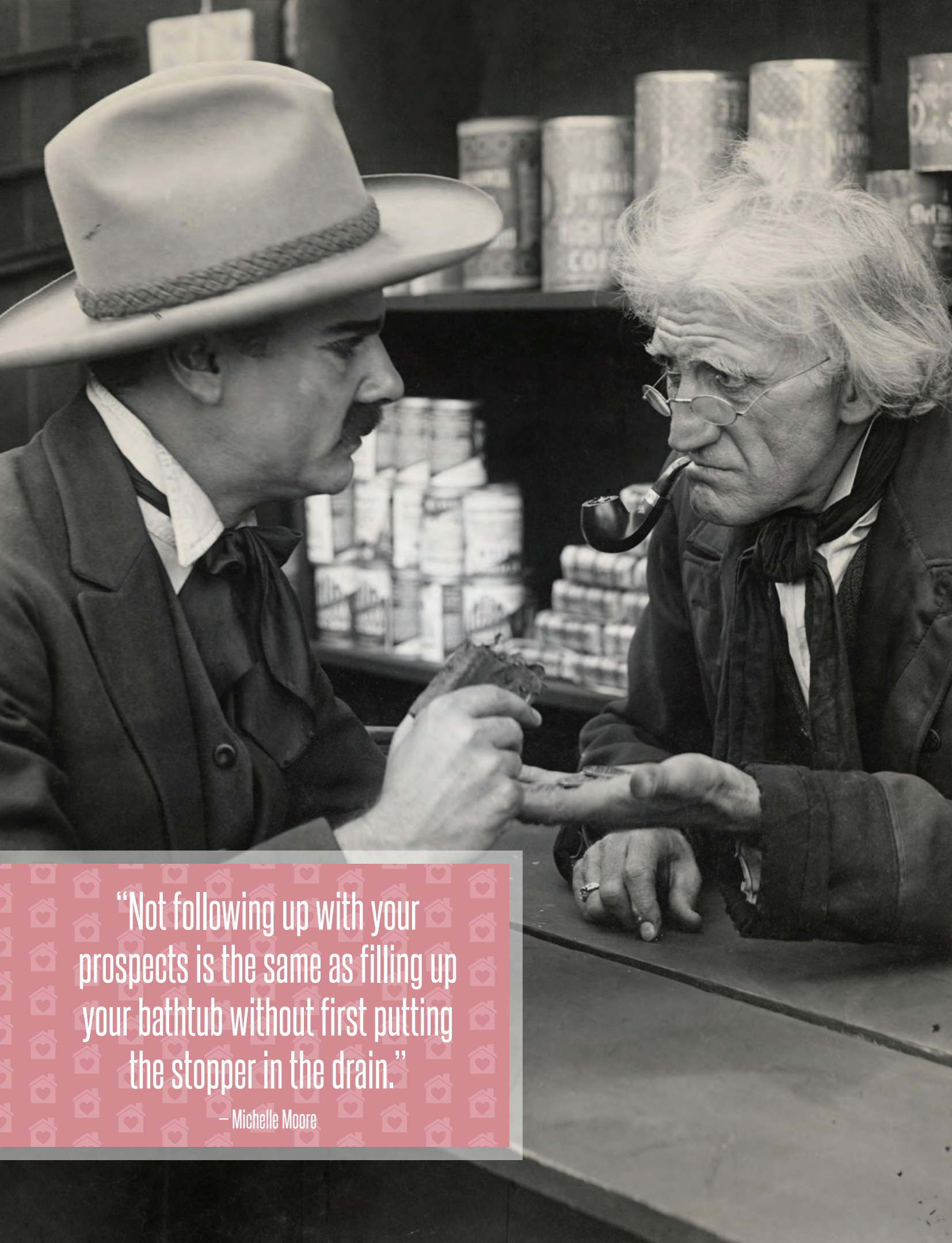
A **Declaration of Homestead** is of no effect until it is recorded.

The **Statute of Frauds** provides that certain contracts must be in writing to be enforceable. Most contracts involving the sale and leasing of real estate fall into this classification. One of the exceptions is a lease for a term of one year or less, which need not be in writing. In this case, the law presumes a month to-month tenancy and the burden is upon the renter to prove otherwise. A broker's authorization to sell real property must be in writing or the broker cannot sue for a commission.

A **power of attorney** is an acknowledged written instrument that authorizes one person to act for another in his/her stead. The attorney-in-fact cannot deed or mortgage the principal's property to himself, or otherwise use the property of the principal for the attorney-in-fact's own benefit.

chapter 5 quiz

- 1. A person holding title to real property in severalty would most likely enjoy:**
 - a. A life estate.
 - b. An estate for years.
 - c. Ownership in common with others.
 - d. Sole ownership.
- 2. One of the features of owning real property as tenants in common is:**
 - a. Each co-owner must have equal interest.
 - b. Each owner may not will his/her interest.
 - c. Each co-owner may acquire interest at different times in different instruments.
 - d. The sole survivor owns the property in severalty.
- 3. Tenancy in common would involve all the following, except:**
 - a. Undivided interest.
 - b. Equal or unequal interests.
 - c. Interest passes to devisees or heirs upon death.
 - d. An arrangement for rights of possession.
- 4. The unities of possession, title, time and interest are necessary in order to create the following types of ownership:**
 - a. Tenancy in common.
 - b. Joint tenancy.
 - c. Community property.
 - d. Severalty.
- 5. The unities of time, title, interest and possession relate to:**
 - a. Devisees of heirs acquiring status as tenants in common.
 - b. The theory of survivorship.
 - c. The presumption of a tenancy in partnership.
 - d. An estate at will.
- 6. A corporation cannot hold title to real property as a:**
 - a. Joint tenant.
 - b. Tenant in common.
 - c. Partnership.
 - d. Limited liability company.
- 7. A brother and sister held title to a duplex as joint tenants. Other than this property, their business and personal affairs were conducted separately. When the brother died, he/she was insolvent, and owed several creditors unsecured amounts of money. Title to the duplex would be held by the sister**
 - a. Subject to the processes of probate.
 - b. Subject to the claims of the creditors.
 - c. Free of the debts of the brother
 - d. As tenant in common with the lessees of the duplex
- 8. Community property is property owned by:**
 - a. Churches.
 - b. Husband and wife.
 - c. The municipality.
 - d. A neighborhood complex.
- 9. When real property is held by husband and wife as community property, an agreement to sell that property which has been signed by only one spouse would be considered to be:**
 - a. Illegal.
 - b. Unenforceable.
 - c. Binding.
 - d. A violation of the Statute of Frauds.
- 10. Once the proprietor of a business has filed a fictitious business name statement in the office of the county clerk, it will expire:**
 - a. Never, unless abandoned.
 - b. 10 years from July 1 in the fiscal year in which it is filed
 - c. 5 years from December 31 in the year in which it is filed
 - d. 10 years from the date it is filed.



“Not following up with your prospects is the same as filling up your bathtub without first putting the stopper in the drain.”

— Michelle Moore

CHAPTER 6: *encumbrances*

Learning Objectives

Purchasers of real estate typically receive loans to finance their purchase. These loans encumber the property and affect the title of the property. In this chapter, we feature many of the terms involved with borrowing money while using real estate as the security for the loan.

key terms

Acceleration clause	Encumbrance	Pledge Agreement
Alienation clause	General lien	Power of Sale
Amortized	Holder in Due Course	Promissory Note
Attachment	Hypothecate	Purchase Money Trust Deed
Beneficiary's Statement	Judgment	Radon Gas
Blanket Trust Deed	Lien	Reconveyance Deed
CC&Rs	Mortgage	Right of Redemption
Certificate of Discharge	Notice of Completion	Sale Land Contract
Deed	Notice of Non Responsibility	Seasoned Note
Deed in Lieu of Foreclosure	Notice of Sale	Specific Lien
Deficiency Judgment	Offset Statement	Stakeholder
Discharge	Open-end Mortgage	Statute of Limitations
Due on sale Clause	Package Mortgage	Warehousing
Encroachment	Planning Commission	Wraparound Trust Deed

Encumbrances

The word encumbrance as used in real estate is a general term denoting anything that affects the title to, or limits the use of, real property. It means any right or interest in land possessed by someone other than the owner.

Encumbrances fall into two general categories: Those for money, called liens, which affect the title by making it security for the payment of a debt, and non-money encumbrances, such as easements and deed restrictions.

Encumbrances can be voluntary or involuntary. If the owner, by contractual agreement, allows the encumbrance to be placed against the title, it is voluntary. If the city or county places a tax lien or an easement in gross for utilities on the property without the owner's approval, it is involuntary.

Since most property is encumbered with some type of restriction, easement, or lien, it is common practice for a buyer to accept a deed on encumbered property. Title companies always insure encumbered property.

Money Encumbrances - Liens

A **lien** is defined as a charge imposed upon property by which it is made security for the performance of an act, usually the payment of a debt. It is known as a money encumbrance.

Liens as well as other encumbrances on property are usually imposed by the recording of a document in the county recorder's office.

Liens may be **specific** or **general**. A specific lien is imposed on a single property. A general lien is one imposed upon all non exempt property owned by the debtor in the county where the lien is properly recorded.

Liens may be voluntary or involuntary. When an owner agrees to make property security for a debt, it is a voluntary lien. When a lien is imposed by court or operation of law, it is known as an involuntary lien.

Voluntary Liens

When a borrower voluntarily encumbers property by giving an interest in it as security for a loan, the instrument used for this purpose is known as a security device. A lien is not an estate. It simply encumbers an estate.

Security Devices in General

There are five different ways to give an interest in real estate as security for a loan or extension of credit. These are:

1. Mortgage
2. Trust Deed
3. Deed a parcel of land to the lender to hold until repayment of a loan
4. When anyone holding a mortgage or trust deed note wishes to borrow against it, the holder may use such note and its security, considered to be intangible personal property, as collateral, by transferring it in pledge to a lender. Because of this, it is also referred to as a pledge agreement.
5. Land Contract

Mortgage Warehousing

When one lender places several trust deeds or mortgages with another lender as security on a large loan, the practice is referred to as **mortgage warehousing**. Warehousing operations also refer to mortgage bankers when they arrange a short-term loan from a bank to acquire funds for several take-out loans for buyers of homes. They then use this as security for the large short-term loan. When they collect a number of these individual take-out loans, they will sell them as a portfolio of loans either to Fannie Mae or to some other organization that buys bank loans.

The mortgage bankers whose practice it is to take a portfolio of loans will often receive a line of credit as their business builds in an ethical manner.

Financing requires both a note and a security device (mortgage or trust deed). Should a discrepancy arise as to the maturity date, the discrepancy would be resolved in favor of the note that is, in effect, the actual evidence of the debt. The lien itself is the security device and is incidental to the debt.

Creation of Mortgages & Trust Deeds

All liens on real property may be viewed from three aspects: creation, release, and foreclosure. Each type of lien will be treated in that order.

Mortgages

Type of instrument: A mortgage is a written contract by which specific property is hypothecated to secure a debt or obligation. **Hypothecate** means to make a property security for a loan without delivering possession of the property to the lender. Because the mortgage conveys no right of possession, it is not an estate in real property. Since the instrument itself is a lien on real property, it is transferable by the lender (mortgagee) but is not a negotiable instrument in the true sense of the word.

Parties: There are two parties to a mortgage—the mortgagor (borrower) and the mortgagee (lender).

Title: There is no transfer of title in a mortgage. The buyer retains full title and the use of the mortgaged property.

Effect on title: The mortgage contract creates a lien on the property of the borrower so that if the borrower does not repay the note that he or she signed as actual evidence of the loan, the lender may take steps to have the property sold to pay the debt.

Trust Deeds

The mortgage and trust deed have the same purpose, which is to make real property security for a loan. They are also similar in the fact that the borrower, in each case, retains possession of the physical property. The procedure employed in using the trust deed differs from that of the mortgage.

Type of instrument: The security given is not a contract, but a special form of deed used to hypothecate the title. In this way, it differs from a mortgage, which only places a lien against the title. It is also a trust instrument.

Parties: There are three parties to a trust deed—the trustor (borrower), the beneficiary (lender), and the trustee (a third disinterested party, a sort of stakeholder).

The beneficiary under a trust deed, mortgagee under a mortgage, and owner under a land contract are all similar in that they are all lenders.

Title: The bare legal (naked) title to the property is conveyed by the trust deed from the borrower (trustor) to the trustee upon the signature of the trustor, to be held in trust until the loan is repaid. The lender holds the actual trust deed and note as evidence of the loan.

The relationship between the beneficiary and the trustee is fiduciary in nature because the trustee can only act on the direct orders of the beneficiary.

For a trust deed to be valid, it must:

- ▢ Be in writing
- ▢ Be signed by the trustor
- ▢ Name the trustee
- ▢ Have a granting (trusting) clause
- ▢ Have a sufficient description of the property.

Effect on title: The trust deed, in effect, creates a lien against the property in that, if the borrower does not repay the note as agreed, steps can be taken to sell the property to repay the debt.

Once created, both mortgage and trust deed instruments are personal property, even though they are evidence of an encumbrance on real property.

There are many clauses found in mortgage and trust deed instruments, but they are not concerned with the validity of the trust deed. The validity is evidenced by the recording of note and security, not by the legal rights and defenses inserted into the instruments.

Package Mortgage

The growing popularity of the practice of selling in one package not only the land and the structure erected thereupon, but including fixtures for comfortable living such as stoves, refrigerators, air conditioners, dish-washers, etc., has brought about the use of what is called the **package mortgage**. It contains the statement that such articles “are and shall be deemed to be fixtures” and are to be considered in all respects as a part of the real estate that serves as the security.

Fictitious Mortgage or Trust Deed

The full-length form of a mortgage or trust deed is generally two pages of closely set print. To avoid duplication in the Recorder’s Office and to reduce the forms to one page, the law allows the recording of a basic set of provisions known as a fictitious mortgage or fictitious trust deed. This permits these provisions to be incorporated into any short form mortgage or trust deed by reference to the recorded fictitious document, giving the book, page, and date of the recording in the county recorded.

Open-end mortgage: One which provides that the outstanding balance can be increased to advance additional loan funds to the borrower, up to the original sum of the note.

Wrap-around trust deed (also called an all inclusive trust deed): Wrap-around financing is financing to which the trust deed is subordinate yet includes the encumbrance or encumbrances to which it is subordinated.

One of the facts that should be remembered when using this form of financing is that, for federal income tax purposes, the buyer is not considered to have assumed the existing first loan in the year of the sale.

Grant Deed as Security

When a grant deed is given as security for a loan, it is considered inequitable (unfair) that the lender should be able to keep title for an amount less than the value of the property. Legally, such a deed would only be valid as a mortgage, would operate as a mortgage, and would have to be foreclosed as a mortgage. It is often referred to as an old mortgage or disguised mortgage.

Pledge Agreement

In a situation where a lender is holding a mortgage or trust deed as security on a parcel of real property, the lender holds a lien on that property and has a right to collect on the note. This lender may, by himself, borrow on his right to collect from the property, using his mortgage or trust deed and note as collateral. Since he would then be obligated to leave the actual mortgage or trust deed and note as security with the person from whom he is borrowing the money, the security device used for this type of transaction is known as a **pledge agreement**.

Land Contract

An **agreement of sale** or **land contract** is also called a security device. It allows a seller to extend credit in selling property where the purchaser does not have sufficient cash for a large down payment.

When selling a property using a land contract, the seller retains title to the property as security until the buyer has repaid the money in full or has paid in a sufficient amount to warrant transfer of title (depending upon agreement of the parties). This method is used under the California Veterans Home Purchase Act (CalVet) where the California Department of Veterans Affairs buys the property in the name of the State of California and resells it to the veteran on contract. Under this program, title is not transferred until the money has been paid in full.

Effects of Making Property Security for a Loan

While the trustor is making repayment of a trust deed note and does not default, the trustor remains the true owner of the property—holding what is known as equitable title—and has all the customary rights to possession, rents and profits, transfer, and to further encumber the property. The trustor is known as the equitable owner of the property. Equitable ownership is also created on behalf of a buyer at the time the land contract is signed; the buyer also has all the customary “rights,” except that the buyer cannot further encumber the property. In all of these transactions, the buyer acquires the right to the legal title when the buyer has performed the terms of the contract.

Different liens upon the same property have priority according to the time of their recording. A first trust deed, as the name implies, has first claim on the property, except taxes or previously recorded liens (such as mechanics' liens, judgments, etc.). If, at a foreclosure sale, there are no such previous liens, the proceeds go first to pay cost and expenses of sale, then to pay off the holder of the first trust deed. Any amount left over is applied to the payoff of a second trust deed note or other subsequent liens, in the order of their recording. Should the funds be exhausted before the last recorded trust deed note is paid, the beneficiary of that note will lose their money. Should funds still remain, the trustor receives any balance remaining after all other claims have been paid.

Request for Notice of Default

Any person interested in a particular deed of trust, such as a junior lien holder, may make sure of being informed of a notice of default and notice of sale. The holder of a second trust deed, for instance, would be vitally interested in knowing of any default on the first trust deed. The holder of the second trust deed has the right, during the default period, to make up all past payments and cure the default on the first trust deed. The monies used to accomplish the cure are then added to the monies due to the second trust deed holder and become in default to that individual, or institution. The second trust deed holder then proceeds to begin a new foreclosure and, unless there is a due on sale clause, preserve all rights to maintain the first trust deed in place upon, during, and following the foreclosure sale. To make certain that such default does not occur without the holder's knowledge, the holder of a junior trust deed may record a request for notice of default with the county recorder in that county in which the property is located. The trustee or other person authorized to record the **notice of default** or **notice of sale** must, within 10 days after recording, inform the person named in the request of notice of any such recorded document by mailing to that person a copy of the document.

A trustee, mortgagee, or any other person entitled to record a notice of default must send copies by certified or registered mail, postage prepaid, to any interested parties within one month of the recordation of the notice of default. They must also send the same parties notice of the date and place of the sale at least 20 days prior to the date of sale. This is in addition to those who have requested a notice of default.

The persons who are entitled to be mailed such notices are those who have acquired their interest or estate by an instrument sufficient to impart constructive notice by the recording of such interest. The recorded instrument must set forth a mailing address to receive a notice.

Sales of Mortgages and Trust Deeds

Mortgages and trust deeds may be sold or assigned by endorsing the note and making out an assignment form that may be recorded. The sale or assignment of such note carries with it the security for the note. This has the effect of changing the mortgagee or beneficiary but not the titleholder.

Sale of Property Held as Security

The owner of property that is encumbered by a mortgage or trust deed may transfer or sell the title to the property. This transfer is accomplished in the same manner as any sale or transfer. The title to such property will remain encumbered with all liens that were on it at the time of transfer. Some trust deeds and mortgages have a clause prohibiting transfer without paying off the total amount of the note. Such a clause is called an **alienation** or **due on sale clause**. This clause would not stop the transfer but, if transferred, the property could be foreclosed upon.

Refinance

Should a seller want to refinance a first trust deed or mortgage loan and the secondary financing is not subordinate to the creation of a new first loan, the second trust deed must be paid in full.

Beneficiary's Statement

A beneficiary is a lender involved in a trust deed. When an individual or an escrow wishes to determine the exact balance of a loan as of a given date, together with accrued interest, interest rate, and other items of the loan, they ask the beneficiary (the lender) for a **beneficiary's statement**. A lender must provide such a statement but may charge a fee for this service.

Beneficiary's Rights

The beneficiary has a clause in the trust deed that approval must be obtained by the lender before one would adjust the boundary lines of the property serving as security. One would also need approval to consolidate the property with other properties, and would also need approval before signing any agreements in the neighborhood regarding restrictions on the use of the property.

After-Acquired Title

Because a grant deed conveys any after-acquired title (e.g., additions of fixtures to the real property or improvements to the land), it follows that, because of the use of a deed in trust deed financing, the after-acquired title would pass to the trustee as additional security.

Offset Statements

Frequently, when the security is sold or assigned, or when the property is held as security, the purchaser of the property will demand a statement as to the amount, interest, and condition of the trust deed or mortgage. This statement is called an **offset statement**. When the property is purchased subject to the security, the purchaser will want such a statement from the lien holder. When the trust deed or mortgage (the security) is purchased, the buyer will want an offset statement from the owner of the property. If the offset statement is given by a beneficiary, it may be called a beneficiary's statement; when issued by a mortgage holder, it may be called a mortgagee's statement; when given by the seller under a land contract of sale, it may be called a vendor's statement.

When income property that is subject to leases is sold, the purchaser may want a statement from the lessee as to the terms of the lease, which shows the term, rent, security deposit, etc.

The law provides that such statements must be given by the security holder. Every mortgagor, trustor, or vendee under a land sales contract shall be entitled to an annual account of all moneys paid without charge. If additional accountings are requested, the mortgagee, beneficiary, or vendor must deliver such copies upon the payment of certain prescribed fees. Failure to deliver such copies as required would subject the lender to penalties.

Release of Mortgages & Trust Deeds - Clearing the Record

When a debt has been repaid, the encumbrance must be removed from the title. This is done by recording another document.

When any mortgage has been satisfied, the mortgagee is required to cause to be recorded a **Certificate of Discharge**.

When any deed of trust loan has been satisfied, the beneficiary is required to execute and deliver to the trustee a request for a full reconveyance. The trustee is required to execute and record, or cause to be recorded, a full reconveyance. The instrument is called a **reconveyance deed**.

Blanket Financing

When financing the construction of many homes in a subdivision, a contractor will use one trust deed to finance all the homes. The trust deed is called a **blanket trust deed** and contains a provision that, as each home is sold, the lot will be given a partial release from the blanket trust deed and a new trust deed will be created on that one lot to finance the purchase.

When exercising the provisions of a release clause in a blanket encumbrance by paying off a part of the lien, the borrower will receive and record a partial reconveyance deed releasing part of the property held as security.

A blanket form of financing will cost more in points and interest because a lender's primary concern is the repayment of the sum lent. The security for making the loan is the most important factor. Therefore, the lender will require the developer to pay more money than the value of the lots that are released. The lender would be concerned if the developer secured the release of the best (most valuable) lots first, unless an amount of greater than the average price per lot were paid to secure the release.

A pledge agreement would be satisfied or terminated by a reassignment of the security used.

A land contract would be terminated as a security device by the conveyance of the legal title to the buyer by the seller.

Section 2941 of the Civil Code sets forth the procedure to be followed upon the satisfaction of an obligation secured either by a mortgage or a deed of trust.

With respect to a mortgage, the mortgagee within 30 days of the satisfaction must execute and record, or cause to be recorded, a Certificate of Discharge in the office of the county recorder in the county in which the mortgage is recorded.

With respect to a deed of trust, the beneficiary is required to execute and deliver to the trustee the original note, deed of trust, request for full reconveyance, and any other documents needed to re-convey the deed of trust. The law does not establish any time limit within which the beneficiary must deliver these documents.

Following the repayment of a debt secured by a trust deed, the trustee must sign and execute the full reconveyance and record it or cause it to be recorded in the office of the county recorder in which the deed of trust is recorded. The trustee must do this within 21 calendar days after receiving the original note, deed of trust, and request for full reconveyance.

Upon a written request from the mortgagor or the trustor, the mortgagee or the trustee must deliver the original note and the mortgage or trust deed to the person making the written request. In the case of a trust deed, the trustee must also deliver a copy of the reconveyance to the beneficiary.

If the trustee has failed to execute and record the full reconveyance within 60 calendar days of the satisfaction of the obligation, the beneficiary, upon written request of the trustor, must execute and acknowledge a document substituting the beneficiary or another as trustee and issue a full reconveyance.

If a full reconveyance has not been executed and recorded within 75 calendar days of satisfaction of the obligation, then a title insurance company may prepare and record a release of the obligation. However, at least 10 days prior to the issuance and recording of such a release, the title insurance company must mail notice of the intention to release the obligation to the trustee and beneficiary of record at their last known address.

This release is entitled to recordation and, when recorded, is deemed the equivalent of a reconveyance of a deed of trust.

Anyone who violates the provisions of this law is liable to the person affected for all damages that person may suffer by reason of the violation, and the violator may be fined.

The trustee, beneficiary, or mortgagee may charge a reasonable fee to perform the services required by this law.

As we have seen, there is a procedure for the release of the lien of a mortgage or a deed of trust when the underlying obligation has been fully satisfied, and when the present mortgagee or beneficiary of record cannot be located after diligent search or refuses to execute and deliver a proper certificate of discharge or request for reconveyance. Whenever a balance of the principal and interest remains due and the mortgagee or beneficiary (trustee) cannot be located, the lien of the mortgage or the trust deed would be released upon recordation of a bond containing specified information.

Foreclosure - Mortgage

Generally, there is only one remedy or method by which to enforce the payment of debt if the mortgagor fails to make payment as agreed; institute an action in court called a foreclosure suit. When a court trial is held and the default established, the court orders a sale of the property to be held by the Sheriff or Court Commissioner. Notice of Sale must be posted in a public place for 20 days and published once a week for 20 days before the sale can take place.

At the sale, the property is sold to the highest responsible bidder who does not, at the time of the bid, receive either a deed or possession of the property. The bidder receives a Certificate of Sale, which states that if the mortgagor does not redeem the property within one year, the buyer will then receive a Sheriff's or Court Commissioner's deed.

Right of Redemption: The period during which the mortgagor has the right to redeem his/her property by paying off the debt, interest, and costs incurred within one year after the foreclosure sale is known as the period of redemption. During this period, the mortgagor retains possession. The mortgagor may sell his/her right of redemption and the grantee would have the right to redeem.

If the property is a home, the mortgagor may live in it during the year, and if the mortgagor redeems, the buyer at the sale cannot collect any rent from the mortgagor. If the mortgagor fails to redeem, the mortgagee may sue the mortgagor for reasonable rent. If the foreclosed property is business or income property, the buyer at the foreclosure sale is entitled to the rent and profits therefrom, unless the mortgagor redeems, in which case this money is applied towards the redemption amount.

Deficiency Judgment: If the foreclosure sale does not bring enough to pay the mortgage and costs, the mortgagee may ask for a deficiency judgment, except in the case of a purchase money mortgage.

Statute of Limitations: Should a lender fail to take action to foreclose a mortgage in default within four years of the due date of the note, the lender would be barred from taking action under the Statute of Limitations. In other words, both the note and the mortgage outlaw four years from the date the note is due and payable. This does not mean the debt is wiped out, only that the courts cannot be used to enforce payment.

Power of Sale Provision: Sometimes a mortgage will contain a **Power of Sale** whereby, upon default, the mortgagee can cause a sale of the property without taking court action. In this case, the mortgagor does not have an equity of redemption, but he does have the right to reinstate the loan within a limited period. This power of sale is lost, however, when the debt is outlawed by lapse of time. It outlaws along with the note and mortgage contract.

Trust Deed

A trust deed may be foreclosed in two ways:

1. As a mortgage
2. By trustee's sale.

As a mortgage: In this type of foreclosure, the procedure is identical to a mortgage foreclosure in court, except that if a deficiency judgment is not asked in the foreclosure, the trustor has no right of redemption after the sale. If a deficiency judgment is asked for in the foreclosure, the trustor has one year to redeem (the same as in a mortgage).

In the judicial foreclosure of a trust deed, when the price bid at the sale is for a sum less than the amount of the judgment, the period of redemption for the trustor would be one year. Should the bid price be equal to or greater than the judgment sum, the redemption period would be three months.

By trustee's sale: This type of foreclosure action provides the reason for the almost exclusive use of trust deeds in California. The security (real property) can be sold outside of court in a comparatively short time and there is no redemption period for the trustor-borrower.

It should be recognized that a trustee is appointed by a beneficiary. In institutional financing, the trustee is usually a corporation owned by the lending institution. No state or federal law governs the licensing or activities of a trustee.

Default

When a borrower defaults in payments or otherwise jeopardizes the security, the beneficiary notifies the trustee in writing of the default and requests that the trustee take steps to foreclose. The trustee prepares and records a Notice of Default, setting forth the identification of the trust deed, the nature and extent of default, and stating that the beneficiary has elected to sell, or cause a sale of the property, to satisfy the obligation. A copy of the notice is sent to the trustor. This notice states that three months after its recording, the trustee may advertise the property for sale. It also states that until five business days before the sale takes place, the trustor has the legal right to reinstate the loan in good standing by paying all past due payments, plus costs and expenses.

In the event of default on a first trust deed, the holder of the second lien may make the payments on such first lien (reinstate it) and then foreclose under the holder's own lien. This action will require another three-month and 21-day waiting period after the filing of the notice of default by the holder of the second or any other junior lien. The reinstatement of the first lien by the junior lien holder is known as making an advance.

Notice of Sale

If the trustor takes no action during the three-month waiting period, the trustee executes a Notice of Sale that must be published in a newspaper of general circulation at least once a week for at least three weeks, with the first date of publication being at least 20 days before the date of sale. The notice must state the time and place of sale, describe the property to be sold and the occasion for the sale. A copy must be posted for the same period of time in a public place in the city or judicial district where the property is to be sold and in some conspicuous place on the property itself. A copy of this notice must be mailed to all lien holders, whether or not a Request for Notice was recorded.

During the 20-day period of publication, the trustor may reinstate the loan by paying all past due payments plus permitted costs and expenses prior to five business days before the sale is to take place. During the five business days immediately prior to the sale, the trustor must pay off the entire loan plus permitted costs and expenses to prevent the sale from taking place. During the foreclosure, the trustor may stay in possession of the foreclosed property. Following the sale, the trustor has no recourse. All rights, including possession, are terminated. The total process takes about four months.

Upon default of a mortgage or trust deed, most standard forms provide that the beneficiary or mortgagee may reserve the right to collect the rents.

Persons bidding at a foreclosure sale are required to bid cash, except that the lender may bid up to the amount of the unpaid balance due to the lender, without tender of cash. The highest and accepted bidder receives title by a trustee's deed.

The money paid at the sale is dispersed as follows: After the trustee's cost of sale, there would be normal priority distribution such as first trust deed, second trust deed, etc. Any remainder would go to the trustor.

To prevent an owner from having a negative impact on his/her credit, an offer can be made to the holder of the note in default to provide a **Deed In Lieu of Foreclosure**. If this deed is accepted by a lender from a defaulting borrower, both lender and borrower avoid the necessity and expense of foreclosure proceedings. The lender would, under these conditions, become responsible for the payment of any liens recorded after the lien the lender holds.

Doctrine of Relation Back

The title of the successful bidder is deemed to relate back, or be the same as the title of the borrower as of the date he or she executed the note for the loan. Therefore, the buyer at a foreclosure sale is not liable for intervening liens, except for taxes.

Expiration of Lien

Unless the lien of a mortgage, deed of trust, or other instrument that creates a security interest of record in real property to secure a debt or other obligation has expired earlier, as provided in other law, such lien expires:

- Either 10 years after the last date fixed for payment or performance of the obligation is ascertainable from the record, or
- If this cannot be determined from the record, then 60 years after the instrument that created the security interest or other obligation was recorded. Therefore, it cannot be stated that a trust deed never outlaws.

Deficiency Judgments: No deficiency judgment may be had at or following a trustee's sale. A judgment can be secured only in a court of law. If the foreclosure proceedings are not in court, a judgment cannot be obtained and the lender must be content with the proceeds of the sale.

It is also a matter of law that a deficiency judgment may not be obtained in the foreclosure of residential (one-to-four units) purchase money encumbrances.

If the sale of a property foreclosed by court action does not bring enough money to pay the debt, the court may award a deficiency judgment that makes other properties of the debtor liable for the payment. Such judgments are based upon the difference between the balance due on the foreclosed note, plus costs (up to the market value of the property as set by the court) and the proceeds received from the sale.

Purchase Money Encumbrances

A **purchase money trust deed** or mortgage can arise only when there is the extension of credit to a buyer by the seller, or an actual loan of money by a third party enabling the buyer to purchase and reside in certain types of property. In California, a purchase money trust deed is advantageous in the eyes of the lender because it would take priority over a buyer's liens at the time of purchase.

Two sets of circumstances arise in determining what a purchase money encumbrance is. They are:

1. Where the seller extends credit to the buyer by taking back a trust deed or mortgage as all or part of the purchase price on the property being purchased. It could be a first, second, or third encumbrance, with the seller accepting the note instead of cash.
2. Where some third person or institution lends part or all of the funds to the buyer to purchase a property of less than five residential units, and the buyer resides in one unit and gives the lender a trust deed or mortgage on such property. (Note: In this second instance, if the buyer does not reside in one unit or, regardless of residence, if the property is five units or more, it is not classified as a purchase money encumbrance. A deficiency judgment may be secured if foreclosed as a mortgage against.)

Once a trust deed or mortgage has been created under either set of circumstances, it is classified as a purchase money encumbrance and its subsequent assignment, or the sale of the property so encumbered, does not change the character of the encumbrance.

The only reason to consider whether an encumbrance is purchase money is in a determination as to whether a deficiency judgment may be obtained upon foreclosure in court.

Regardless the classification of the encumbrance, if the money was actually loaned by a third party, it is known as a hard money encumbrance.

Land Contracts

A land contract or agreement of sale (also called a conditional sales contract) does not require formal foreclosure proceedings because the legal title has not been transferred. When a purchaser of real property under a land contract defaults, the usual method of clearing title or regaining possession of the property is to secure a quitclaim deed from the purchaser or, failing that, to institute quiet title action in the appropriate court.

If a quiet title action is necessary, it may take a considerable length of time for the court proceedings if the purchaser chooses to contest the action.

Promissory Notes

A note, or **promissory note**, is the primary evidence of the obligation to pay money. The obligation or promise is secured by the mortgage or trust deed.

The transfer of the note carries with it the security for the note, even though the actual security is not transferred.

A promissory note is a written promise, signed by the maker or promisor, to pay a specified sum at a time therein limited, or on demand, or on sight, to a person therein named, or to that person's order or bearer.

A note may be signed by more than one person as a "joint note," indicating that each is equally liable for its payment, or as a "joint and several" note, making them jointly and individually liable for the entire amount.

Types of Notes

Today, most real estate loans are fully **amortized**; that is, the note provides for repayment in equal installments over a period of years. A portion of each payment covers the interest earned up to that point; the remainder is a repayment of the principal. Some loans require a set amount to be paid on the principal in each installment plus any accrued interest.

It should be noted that most conventional real estate loans utilize simple interest. Simple interest is defined as interest calculated on the principal amount of the loan only. Other forms of calculating interest include compound interest and add-on interest. Compound interest is defined as calculating interest on principal and accrued interest, which normally involves savings for investments. Add on interest is generally used in automobile loans where the interest for the full principal for a three-year loan would be added to the loan. That amount would be divided by 36 and paid off in those installments. Savings accounts normally pay compound interest, while real estate lenders charge simple interest.

Should an amortized note call for payment of a certain sum each month plus interest, this means that in addition to the principal payment required, which will apply to paying off the principal sum, the borrower must pay the amount of interest due at that time.

If the amortized note calls for a specified payment including interest, then the amount of the payment includes the amount of interest. Only the difference between the payment itself and the amount of interest due can be applied to paying off the principal sum. In such case, the amount of the principal payment increases and the amount of interest payment decreases each month as the balance of the principal sum is gradually reduced.

In addition to fully amortized loans, partially amortized loans are used a great deal in real estate. In a partially amortized loan agreement, there will be a final payment that is larger than any of the other installment payments that must be paid to clear the debt. This final, large payment is most often referred to as a **balloon payment**.

Graduated payment note: Graduated payment mortgages have a fixed interest rate and payments that increase during the loan. This kind of mortgage note often creates a negative amortization, increasing the amount of the loan instead of paying it off.

Straight Loans

A **straight note** (often used in “alternative financing” arrangements and in seller financing arrangements) provides for repayment of the entire amount of principal and interest in a lump sum at maturity. It may provide for periodic payments of interest only, with the principal all due and payable at a specified date.

“Or more” clause: By agreement between the parties, it may be arranged that the borrower may elect to pay an amount greater than the specified monthly payment, or even to pay off the entire amount of the loan before maturity, without penalty.

Prepayment penalty clause: Generally speaking, financial institutions and other lenders dependent upon earned interest for income do not wish to have loans paid before maturity. The unexpected payoff of a loan would mean that the money would have to be reinvested; otherwise, it would not be earning interest. To provide time for such reinvestment without loss of interest, the note will state that if the borrower wishes to pay off the debt in full before the due date, he or she must pay the lender an additional sum as penalty for such prepayment. This clause is often waived if the buyer obtains financing from the same lender.

Any loan for residential property of four units or less, executed on or after January 1, 1980, may be prepaid in whole or in part at any time. However, prepayment made within five years of the date of execution may be subject to a prepayment penalty. An amount not exceeding 20% of the original principal amount may be prepaid in any 12 month period without penalty. A prepayment charge may be imposed on any amount prepaid in any 12-month period in excess of 20% of the original amount of the loan, of which penalty shall not exceed an amount equal to the payment of six months advance interest on the amount prepaid in excess of 20% of the original principal amount. After such loans have been in existence for more than five years, no prepayment penalty may be charged.

Acceleration clause: An acceleration clause in a mortgage, trust deed, or land contract causes the entire balance of the note to become immediately due and payable upon the happening of a certain stated event. This event may be a default in payments, destruction of the improvements, transfer of the property, or any other agreed upon reason. The event must be stated.

Alienation clause (due-on-sale clause): When the event that causes a note to accelerate (become immediately due and payable) occurs in the sale or transfer of the property, such provision is known as an alienation clause. When such a clause is in a mortgage or trust deed secured by one-to-four residential units, it must be stated in both the mortgage and trust deed. To alienate means to transfer title.

A **seasoned note** is a note that has a history of prompt payments.

Uniform Negotiable Instruments Act

All states have passed what is called a Uniform Negotiable Instruments Act. Usually, when a promissory note is sold to another person, the person who takes the note has no greater rights to collect it than the person from whom he or she received it. To promote the ready acceptance of commercial paper such as notes, checks, drafts, bills of exchange, etc., the Uniform Negotiable Instruments Act was passed. The effect of this law is to give a third person to whom the note is sold greater rights to collect the money from the maker (the person who signed it) than the original payee (the person who first loaned the money) had. However, in order to have a note, etc., come under this law, it must meet certain requirements and when sold, it must be negotiated rather than merely transferred or assigned.

A note, to be negotiable under the law, must conform to the provisions of the law. These are:

- ▢ Unconditional promise
- ▢ In writing
- ▢ By one person to another
- ▢ Signed by the maker
- ▢ Payable on demand or at a fixed future time
- ▢ A sum certain in money
- ▢ Made to “order” or “bearer.”

If any one of these requirements is missing, the note may be enforceable but is not negotiable.

The manner in which the note is negotiated will affect the rights of the party to whom it is given. If it is made out to “bearer,” delivery is sufficient. If made to “order,” the note must be endorsed on the back by the payee.

There are various types of endorsements, including:

- ▢ Blank: The holder simply signs the back of the note.
- ▢ Special: The holder writes “Pay to the order of (named transferee)” and then signs.
- ▢ Restrictive: The holder restricts future negotiation by writing, “Pay to the order of State Bank for Deposit Only” and then signs.
- ▢ Qualified: The holder adds the words “Without Recourse” to what would otherwise be a blank or special endorsement.

A **holder in due course** is one who takes a note by negotiation, which is by endorsement by the original payee. The holder in due course is the person who, under the Uniform Negotiable Instruments Act, may have a greater right to collect the note from the maker than the original payee may have. To be a holder in due course, this third person must not only acquire the note by negotiation (endorsement), but must, at the time, acquire it in the ordinary course of business, in good faith (without knowledge of any defects), before maturity (due date), and for value.

When it is said that the holder in due course has a greater right to collect from the maker than the original payee, it is really meant that the maker has fewer defenses against payment to a holder in due course than he or she has against the original payee. The maker of a note may have a variety of defenses (legal reasons for not paying) against payment. All of these legal defenses are available against the original payee. Not all of them are available against a holder in due course.

To determine which defenses are available against the original payee and/or against the holder in due course, defenses are separated into two categories:

1. Personal defenses
2. Real defenses.

Both types are good against the original payee, but only real defenses are good against the holder in due course. A recent Federal Trade Commission regulation rule limits the use of the “holder in due course doctrine” in consumer transactions. Thus, personal defenses may be available against both the original payee and the holder in due course.

Personal defenses are:

- ▢ Fraud in the inducement
- ▢ Lack or failure of consideration
- ▢ Prior payment or cancellation
- ▢ Set off.

Real defenses are:

- ▢ The maker was a minor or incompetent
- ▢ Note was given for illegal conduct
- ▢ Forgery
- ▢ Material alteration

It is because of the inability of the maker to claim personal defenses against a holder in due course that negotiable notes are readily acceptable in trade and commerce without careful investigation of the credit of the maker and the circumstances surrounding the creation of the instrument.

Although trust deeds and mortgages are not negotiable, the notes are considered to be negotiable, even though they carry a trust deed or mortgage as security. Negotiability is not affected by the inclusion of an acceleration clause, making the remaining principal become due and payable in the event of a certain happening or by one providing for court costs and attorney’s fees in the event of court action to collect. These make the note more acceptable to lenders and enhance marketability. Mortgages and trust deeds are usually assigned and the assignment is recorded in order to take advantage of the recording act.

Involuntary Liens

Liens other than security devices are involuntary liens placed on the title against the expressed will of the owner. These liens are:

- Real property taxes
- Personal property taxes (generally)
- Special assessments
- Attachments
- Judgment liens
- Mechanics' liens
- State or Federal Income Tax Liens.

Attachments (Specific Lien)

Attachment is a process by which real or personal property of a debtor is seized and held in the custody of the law as security for satisfaction of a judgment the creditor hopes to secure as the result of a lawsuit. The attachment creates a lien against the property and the property may not be sold without payment of the lien, release of the attachment, or the posting of an appropriate bond.

Certain property is exempt from attachment or execution when proper claim is made for exemption. The list of such exemptions is long and varied, including the major exemption of a homestead declaration, at least part of the earnings of the defendant, tools of his/her trade, household effects, wearing apparel, etc.

To create an attachment, the creditor (at the time of filing a lawsuit) obtains from the court a Writ of Attachment. This is an order for the sheriff or other official to seize and hold the property. If the debt is paid or sufficient property is sold to satisfy the debt, the attachment lien must be removed as an encumbrance. This is done by a Release of Attachment. An attachment is a specific lien and is good for three years or until final judgment, whichever occurs first.

Judgments (General Lien)

A **judgment** is an involuntary general lien and is a final order of a court as the result of a lawsuit. The details of the judge's determination of the rights of the parties is called an Abstract of Judgment. Until such an abstract is recorded, it has no effect upon the property of the debtor. When recorded, it becomes a general lien on all non exempt real property owned by the debtor in the county in which the abstract is recorded or on property that the debtor may acquire in that same county in which the judgment is effective.

If the losing party to a lawsuit pays voluntarily, there is, of course, no need for further action. If the judgment is not paid and the winning creditor wishes to force payment, he or she must take court action to secure a Writ of Execution, which authorizes the sheriff or other official to seize and sell the property to satisfy the judgment.

At such forced sale, other liens on the property are paid off first, in the order of their recordation. Therefore, if a judgment creditor should force a sale of a property on which there is a first and second trust deed totaling \$100,000, and the judgment was for \$20,000, the property would have to sell for more than \$120,000 plus costs if the creditor is to collect anything on the judgment lien.

When a judgment has been paid, the holder of the judgment lien executes a release known as a Satisfaction of Judgment, which is then recorded.

The lien of a judgment does not attach to real property that is exempt from execution, such as the statutory exemption to homestead property.

Mechanics' Liens (Specific Lien)

California law expressly provides that where a person who furnishes labor or material for the improvement of real property is not paid for such labor or material, that person may file a lien upon the property that has been improved by the person's effort, under the theory that improvements contribute additional value to the land. Therefore, it is only equitable to charge such land with the cost of the improvement.

This charge may exist and normally does exist, even though there is no direct contractual relationship between the worker or material supplier and the landowner. However, to become a lien, it must be founded upon a valid contract with the contractor, subcontractor, or the owner of the property, and is ordinarily good to the extent of labor and material furnished for and used on the job.

In other words, although the owner of the property has no personal contact with a painter, plumber, or supplier of material, if that worker or supplier has a contract with the person or company with whom the owner has a contract, the worker or supplier may individually file a mechanic's lien if they have not been paid for services rendered.

The law makes it mandatory for both subcontractors and suppliers to give the homeowner a notice that work has been done or materials furnished for a job. Such notice must be given within 20 days after first going on the job. Failure to provide notice prevents the subcontractors or suppliers from filing a claim against the property owner. Prior to the enactment of this law, if a homeowner had paid a contractor who failed to pay the contractor's subcontractor and material men, both had recourse against the owner. Owners often require contractors to furnish a performance bond to guarantee payment of debts incurred in connection with the job and to withhold final payment to the contractor until the lien-filing period is over.

The right to file a mechanic's lien extends to all persons and laborers of every class who perform labor or services, and to persons who furnish material or service, such as material suppliers, equipment suppliers, architects, artisans, etc.

A mechanic's lien is of no effect unless it is recorded. Such liens must be verified before they can be recorded. Verification is a sworn statement before a duly qualified officer as to the correctness of the contents of an instrument.

The lien-filing period is set by law. The time varies under different circumstances and is based upon “completion of the work.” Because the law recognizes various alternatives as equivalent to actual completion, it may be very confusing. Since a job may never actually be completed, the law sets forth certain situations that will be deemed equivalent, such as:

- Actual occupation of the structure and stoppage of labor, even though the job is not completed.
- Acceptance of the job by the owner when work has stopped without actual completion.
- Continuous stoppage of labor for 60 days, whether or not a notice of abandonment has been filed.
- Filing of a notice of completion by the owner at the county recorder.

A **Notice of Completion**, properly drawn and verified, should be filed with the county recorder within 10 days after completion of any contract or work of improvement. The Notice of Completion must show the date of completion; the owner’s name, address, and nature of ownership; the location of the property; the nature of the work and the name of contractor performing the work. If the work is not completed, an owner can still file a Notice of Completion if:

- The owner occupies the premises and labor has ceased.
- The owner has accepted the work of improvement.
- Labor has ceased for a continuous period of 60 days.
- Labor has ceased for a continuous period of 30 days and the owner files a prescribed Notice of Cessation.

After a Notice of Completion has been recorded, original contractors have not more than 60 days, and other claimants, such as subcontractors, workers and material suppliers, have not more than 30 days in which to file mechanics’ liens.

If a Notice of Completion is not recorded, then all persons have 90 days after completion to file their claims.

An original contractor is one who contracts directly with the owner or the owner’s agent to do the work and furnish materials for the whole job or a portion of such job. The owner may enter into one overall contract or individual original contracts, such as for plumbing, painting, electrical installations, etc. These original contractors may, in turn, contract with subcontractors, workers, or material suppliers.

A material supplier is not an original contractor but supplies the materials on order of the original contractor. Thus, a material supplier’s claim for a lien must be filed within 30 days if the notice of completion or cessation of work is recorded. Subcontractors and workers fall into the same category.

A preliminary notice within 20 days after services must be given to the owner of the property only by those persons who do not have a contract directly with the owner or who have not performed actual labor or wages, such as a material supplier. It can be put on the invoice to owner. If this notice is not given, the remedy of the mechanic's lien is barred with respect to the work done prior to giving the notice.

The scheme of improvement is the entire project from the very beginning of work to the very end. A mechanic's lien takes effect as if recorded at the beginning of the scheme of improvement. The time of the beginning of the work is of great importance, especially where a question arises as to whether a trust deed or mechanic's lien has priority. For instance, if there was an original contract and the foundation or even the preparation for the foundation of a building is started, then even a lien filed by a workman who performed his services weeks or months later (as would be the case with a painter, for example) would come ahead of and have priority over the mortgage or trust deed recorded after the scheme of improvement commenced. For this reason, lending agencies or anyone else making construction loans check and photograph the property to see and prove that no work has been started or materials delivered before recording the trust deed.

However, when the holder of a trust deed finds that the holder's lien would be inferior to such mechanics' liens, the holder may record a bond for 75% of the trust deed at the time or after recording the trust deed, giving the lien priority over liens for subsequent work and materials but providing a right for all persons and material suppliers to recover upon said bond.

Termination of mechanics' liens may be accomplished in two possible ways:

1. Lien claimants may voluntarily release their liens, as prescribed by law.
2. Since mechanics' liens do not endure indefinitely in the absence of release, they cease to bind the landowner's property after a period of 90 days from the recordation of the lien unless foreclosure action is commenced by the lien claimant within that time period. Present law provides that if the lien claimant fails to commence action to foreclose the lien within 90 days from recording the mechanic's lien, the lien automatically becomes null and void and is of no further force and effect.

A lawsuit to perfect a mechanic's lien must start within 90 days from recording of the mechanic's lien. The court may order the property sold to satisfy the claims. If it does not sell for enough to pay the claim, then the courts may award a deficiency judgment against the owner for the balance.

Notice of Non Responsibility: This is a device used by a person who has an interest in real property and who wishes to be protected against certain mechanics' liens or other claims. For example: An owner may have sold a property on land contract, or he may have leased it, and the occupant orders work done to the property without the knowledge of the owner. If, within 10 days after he discovers work is being done, the owner posts a proper Notice of Non Responsibility on the premises and records a copy with the county recorder, he can protect himself against claims from workers and others who have not been paid for such work. It is most important that the notice be both posted on the premises and recorded. If such posting has not been made, the recorded notice affords no protection.

Note that general liens, specific liens, and money encumbrances affect all the property of the owner in the county where recorded. Examples:

- Judgment liens (state & federal income tax liens treated similarly)
- Lien for a decedent's debts
- Inheritance tax liens (state and federal)
- Corporation franchise tax liens

Specific liens affect only a certain piece of property. Examples:

- Mortgage liens and/or trust deed liens
- Attachment liens
- Property taxes and assessment liens
- Mechanics' liens
- Vendees' liens
- Vendors' liens
- Surety bail bond liens

Non Money Encumbrances - Easements

Easements have been discussed at some length under "Interests in Real Property." They are mentioned again at this point because they fall into the category of non money encumbrances, in that they affect the use of property. As with restrictions, easements may be removed from the records by quitclaim or by a quiet title action.

Reservations, Rights, & Rights of Way

The expression **CC&Rs** is used frequently in real estate practice. It is an abbreviation for covenants, conditions, restrictions, reservations, rights, rights of-way and easements of record. Title to property is usually taken "subject to the CC&Rs."

Covenants, conditions and restrictions refer to deed restrictions on the title.

Reservations indicate that a portion of the title is reserved, or an easement is reserved for the benefit of the grantee, as in mineral rights.

Rights refers to the possible circumstance where a grantor has retained or given a personal right to enter upon the property for some specific purpose, such as a right to fish, cut wood, or obtain water.

Rights of way refers primarily to a privilege to pass over the land of another and is the same as an easement unless the title to the right of way has been granted. Thus, a right of way may be granted (as an easement or title) for the passage of a railway or to lay pipelines.

Leases

This subject is discussed at length under “Interests in Real Property.” A lease, being a right to possession owned by a person who does not hold title, is an encumbrance as well as an interest in property.

Deed Restrictions

Restrictions on real property control the use of the land. They may be imposed by the owner of the land at the time the title is conveyed, or they may be imposed by the government under police powers. If imposed by the exercise of police powers, the restriction is termed zoning and is not an encumbrance. A restriction imposed by the owner at the time the title is conveyed is an encumbrance in that the restriction may be enforced by a person or persons who do not hold title to the restricted land. These are called deed restrictions. There are no restrictions that the law prevents an owner from placing in a deed. The law may make some restrictions unenforceable, such as those that discriminate or prevent the new owner from placing a “for sale” and “for lease” sign in attempting to resell to others, as it infringes on the owner’s right to alienate the property. California Civil Code specifically provides that such a covenant is unenforceable, but the owner may still include them.

There are two general types of deed restrictions:

1. A restriction in the nature of a condition subsequent.
2. A restriction in the nature of a covenant.

A restriction in a condition subsequent can be imposed only by deed and usually has a forfeiture clause that states that the property shall, upon violation of the restriction, automatically revert to the original grantor or maker of the restriction. For example: If the grantor deeds property to the grantee “so long as it is never used as a cocktail lounge,” and the grantee did so use the land, it would revert to the grantor who had originally imposed the restriction.

A restriction in a covenant is more or less an agreement or promise between all lot owners under the restriction, and each lot owner has the right to enforce the restriction by requesting an injunction from the court prohibiting the violation thereof, or to bring suit for damages. This type of restriction often makes the property unmarketable.

A deed restriction may be imposed upon only one parcel of land or upon more than one parcel at the same time. If imposed upon only one parcel, the restriction would be written into the deed at the time the title is transferred. If imposed upon a number of parcels at the same time, as in a subdivision, the grantor would record a Uniform Declaration of Restrictions in the county recorder's office. When such restrictions are imposed upon a number of parcels at the same time, they are imposed for the benefit of all the owners of the individual parcels, and the restrictions may be enforced by any one or any group of the owners affected parcels. They are most often used in exclusive, guarded subdivisions and control the lot size, minimum square footage, type of building, etc.

A uniform declaration describes the properties to be restricted and sets forth the restrictions. At the time when the individual deeds are delivered to the grantees, they will include a "reference" to the Uniform Declaration of Restrictions that has been recorded and will thereby incorporate these restrictions "by reference."

The deed restrictions that have been imposed upon a single parcel of land may only be enforced by the grantor who at some time in the past imposed them or, if the grantor is deceased, by the grantor's heirs.

For the restrictions to be enforceable, it is necessary that the owner have notice of the existence of the restriction. The notice may be either actual or constructive. If the document creating the restriction has been recorded properly, such recording would constitute constructive notice and make it enforceable. Restrictions may cover a multitude of matters, including:

- ▢ Use, such as whether for residential or business.
- ▢ Character of buildings, single family or multiple units.
- ▢ Cost and minimum area, requiring construction to cost no less than a certain sum when erected on a lot in a specified area.
- ▢ Location of structure on the lot, specifying set backs and sidelines.
- ▢ Architectural approval of proposed buildings by a local group designated for that purpose by the declaration.

Because of inflationary and deflationary periods in the economy, the dollar amount of construction is the most difficult restriction to impose.

Deed and private contract restrictions may be removed by:

- ▢ Securing a quitclaim deed from the person who originally imposed the restriction on a single parcel.
- ▢ Quiet title action in court.
- ▢ Recording a notice of cancellation signed by a given percentage of the lot owners, if such is provided for in the contract. If not so provided, it might be that all lot owners would have to give releases or quitclaim deeds before restrictions can be lifted.
- ▢ Noncompliance by a high percentage of other owners having the same restriction would tend to have a court lean toward allowing the restriction to become invalid.

Should an owner refuse to comply with a deed restriction, the action of the court is called an injunction. An injunction is a writ or order issued under the seal of a court to restrain one or more parties to a suit or proceeding from doing an act that is deemed to be inequitable or unjust in regard to the rights of some other party or parties to the suit.

Sometimes, under unusual circumstances, the courts may refuse to enforce otherwise valid restrictions. For example, where the complainant himself has violated them, where there is a very material change in the conditions in the area, or where they have been violated generally by the lot owners.

Governmental Restrictions

The governing authorities of a city or county have the power to adopt ordinances that restrict the use of property, such as establishing zones in which structures must conform to certain standards or to prohibit buildings to be used for business or trade in residential areas. Public authorities may enjoin or abate improvements that are in violation of zoning ordinances, but the title to the land is not affected by this.

Changes in zoning or other restrictions of this nature require application to the **Planning Commission**, which follows an administrative procedure in handling such applications. City and County Planning Commission members are delegated the authority to make recommendations to the City Council or Board of Supervisors.

The Fair Housing Law bars discrimination in the sale or rental of houses with loans backed by the Veteran's Administration or the Federal Housing Administration. In 1969, the coverage expanded to include most multi unit housing, plus real estate developments, home financing, advertising, and service organizations such as a multiple listing system. In 1970, the law expanded again to cover any single family home sold or rented through real estate brokers.

Encroachments

An **encroachment** on real property is defined as a projection of an improvement in whole or in part from one parcel of land onto or into the air space of an adjoining parcel of land. An encroachment by a building, tree, fence, or other structure that rests in part upon the adjoining land will amount to a trespass.

It is possible that the party apparently encroaching may be doing so with legal right. He or she may have gained title to the strip encroached upon by adverse possession or may have acquired an easement by prescription. Of course, the requirements necessary to gain such rights must all be present.

If there is an encroachment for which there is no justification, the owner of the land encroached upon has the right to bring a proper action in court to have the encroachment removed (such as a quiet title or ejectment suit). If not barred by the statute of limitations, the owner may also collect damages for trespass. The statute of limitations indicates that any action for trespass must be taken within three years.

An encroachment in the airspace above the land of an adjoining owner is considered a nuisance rather than a permanent trespass. A cause of action to abate a nuisance is not barred by the lapse of time.

Chapter 6 Summary

A **lien** is a charge imposed upon property, usually for the payment of a debt. It is known as a money encumbrance. Liens may be **specific** or **general**. A specific lien is imposed on a single property while a general lien may be imposed upon many. Liens may be voluntary or involuntary. When an owner agrees to make property security for a debt, it is a voluntary lien. When a lien is imposed by court or operation of law, it is known as an involuntary lien.

When a lender places several trust deeds or mortgages with another lender as security on a large loan, the practice is referred to as **mortgage warehousing**. Warehousing operations also refer to mortgage bankers when they make a short-term loan from a bank to acquire funds for several loans until sold in bulk.

A mortgage is a written contract by which specific property is hypothecated to secure a debt or obligation. **Hypothecate** means to make a property security for a loan without delivering possession of the property to the lender. Because the mortgage conveys no right of possession, it is not an estate in real property. A trust deed differs from a mortgage in that it involves a trustee in addition to a borrower and lender.

An **open-end mortgage** provides for increases in the outstanding balance in order to advance additional loan funds to the borrower.

Most mortgages contain a **Power of Sale** whereby, upon default, the mortgagee can cause a sale of the property without taking court action. When a borrower defaults in payments or otherwise jeopardizes the security, the beneficiary notifies the trustee in writing of the default and requests that the trustee take steps to foreclose. The trustee prepares and records a **Notice of Default**, setting forth the identification of the trust deed, the nature and extent of default, and stating that the beneficiary has elected to sell the property pay off the debt.

Savings accounts normally pay compound interest, while real estate lenders charge **simple interest**.

In addition to fully amortized loans, partially amortized loans are used a great deal in real estate. A partially amortized loan includes a final payment that is larger than any of the other installment payments, referred to as a **balloon payment**.

A **straight note** provides for repayment of the entire amount of principal and interest in a lump sum at maturity.

Prepayment penalty clause is used by some lenders who do not wish to have loans paid before maturity. The unexpected payoff of a loan would mean that the money would have to be reinvested and would not be earning interest until reinvested.

An **acceleration clause** in a mortgage, trust deed, or land contract causes the entire balance of the note to become immediately due and payable upon the happening of a certain stated event. This event may be a default in payments, destruction of the improvements, transfer of the property, or any other agreed upon reason. The event must be stated. When the event that causes a note to accelerate occurs in the sale or transfer of the property, such provision is known as an **alienation clause**. To alienate means to transfer title.

There are various types of endorsements, including:

- ▢ Blank - The holder simply signs the back of the note.
- ▢ Special - The holder writes “Pay to the order of (named transferee)” and then signs.
- ▢ Restrictive - The holder restricts future negotiation by writing, “Pay to the order of State Bank for Deposit Only” and then signs.
- ▢ Qualified - The holder adds the words “Without Recourse” to what would otherwise be a blank or special endorsement.

To create an **attachment**, the creditor (at the time of filing a lawsuit) obtains from the court a Writ of Attachment. This is an order for the sheriff or other official to seize and hold the property.

A **mechanic's lien** is of no effect unless it is recorded. Such liens must be verified before they can be recorded. Verification is a sworn statement before a duly qualified officer as to the correctness of the contents of an instrument. They may take effect prior to the recording date.

Covenants, conditions and restrictions (**CC&Rs**) refer to deed restrictions on the title.

chapter 6 quiz

1. **A lien on real property cannot be:**
 - a. Specific.
 - b. General.
 - c. Performance.
 - d. Voluntary.
2. **The mortgagor in a mortgage transaction is:**
 - a. The holder of the note.
 - b. The lender.
 - c. The person who takes or receives a mortgage.
 - d. The person who signs the note.
3. **Warehousing is an important activity in the field of financing, applies to:**
 - a. Mortgage portfolios.
 - b. Title insurance.
 - c. Corporate trustee.
 - d. Servicing of defaulted loans.
4. **A trust deed differs from a mortgage in which of the following respects:**
 - a. Possession.
 - b. Recording.
 - c. Trustee.
 - d. Amortization.
5. **In the terms of a deed of trust, the power of sale is granted by:**
 - a. Trustor to beneficiary.
 - b. Trustor to trustee.
 - c. Beneficiary to trustee.
 - d. None of the above.
6. **In order for a deed of trust to be valid and enforceable, it must contain a clause requiring the trustor to:**
 - a. Have property insured against fire and other hazards.
 - b. Pay tax assessments before they become delinquent.
 - c. Comply with health laws and police regulations.
 - d. None of the above.
7. **The type of mortgage loan that permits borrowing additional funds at a later date is called a/an:**
 - a. Equitable mortgage
 - b. Junior mortgage
 - c. Open end mortgage
 - d. Extendible mortgage.
8. **“A” owns real property encumbered with both a first trust deed and note and a second trust deed and note. He sells this property to “O” who obtains a new first trust deed to finance the purchase. In this situation, the second trust deed:**
 - a. Will become a first trust deed.
 - b. Will retain the same priority.
 - c. Will have to be paid off.
 - d. Will become a prior lien.
9. **The document used to release a loan secured by a trust deed is the:**
 - a. Deed of reconveyance.
 - b. Certificate of discharge.
 - c. Certificate of sale.
 - d. Mortgagee’s statement.
10. **A mortgagee who finds it necessary to foreclose a mortgage would:**
 - a. Notify the trustee of the default.
 - b. File an attachment.
 - c. Notify the mortgagor of the default, wait 90 days and then publish a notice of default in a newspaper of general circulation.
 - d. File an action in court.



“Our value proposition is
accuracy and convenience.”

— Ben Caballero

CHAPTER 7:

land descriptions & arithmetic

Learning Objectives

Identifying real estate is obviously important to everyone working in the real estate industry. Most agents working in developed areas simply use a street address but real estate must also be legally identified to exclude all other real estate in order to protect the owner's rights in the property. This chapter describes different ways that real estate can be legally identified.

Parcels of vacant land must also be legally identified and measured. Math calculations commonly used in land sales are studied and sample problems are given and solved.

key terms

Cul-de-sac

Government Survey

Humboldt Baseline
and Meridian

Key Lot

Lot Book Descriptions

Metes and Bounds

Mount Diablo Baseline
and Meridian

Range

San Bernardino
Baseline and
Meridian

Tier

Township

Vocabulary

Anchor Bolt: A bolt that securely binds the mud sill to the foundation wall.

B.T.U.: British thermal unit. A standard used for measuring heating and air conditioning capacity.

Backfill: dirt and other matter that is filled in around retaining walls, foundations, or other excavations.

Base and Meridian: In the U.S. Government Survey System, imaginary lines used in the system to identify the location of public lands.

Base Molding: Typically wood used at the lowest part of an interior wall to cover the joint between the floor and wall.

Base Shoe: Molding used at junction of baseboard and floor. Commonly called a carpet strip.

Baseboard: A board placed against the wall around a room next to the floor.

Batte: Narrow strips of wood or metal used to cover joints, internally or externally; also used for decorative effect.

Beam: A structural member transversely supporting a load.

Bearing Wall: A bearing wall is a wall that supports weight of the structure. It is intact during remodeling; you do not remove it. A bearing wall can be at any angle to a door that one wishes, i.e., certain entry halls. Normally, your bearing wall is required to be of stronger construction than would be a partition that does not bear weight.

Bench Mark: A fixed marker from which differences in elevation are measured by surveyors.

Blacktop: Asphalt paving used in streets and driveways.

Board Foot: A measure of lumber one-foot square by one inch thick. (12" x 12" x 1" = 144 cu. in.)

Bracing: Framing lumber nailed at an angle in order to provide rigidity.

Bridging: Small wood or metal pieces used to brace floor joists.

Building Line: A line set by law at a certain distance from a street line in front of which an owner cannot build on his lot. (A setback line.)

Building Paper (Tar Paper): A heavy waterproofed paper used as sheathing in wall or roof construction as a protection against air and moisture.

Built In: Cabinets or similar features built as part of the house.

Casement Window: Windows with frames of wood or metal which swing outward.

Casing: A frame as of a window or door.

Ceiling Height: According to latest FHA requirements, minimum ceiling height in a single-family residential construction is 7'6" (90 inches) or 7 1/2 feet.

Circuit Breaker: An electrical device which automatically interrupts an electric circuit when an overload occurs; may be used instead of a fuse to protect each circuit and can be reset.

Clapboard: Boards usually thicker at one edge used for siding.

Collar Beam: A beam that connects the pairs of opposite roof rafters above the attic floor.

Combed Plywood: A grooved building material used primarily for interior finish.

Commercial Acre: A term applied to the remaining portion of a full acre of newly subdivided land after allowances for public streets, roads and alleys. Approximately 40,000 square feet.

Compaction: Whenever extra soil is added to a lot to fill in low places or to raise the level of the lot, the added soil is often too loose and soft to sustain the weight of buildings. Therefore, it is necessary to compact the added soil so that it will carry the weight of buildings without the danger of their tilting, settling, or cracking. Expensive to a contractor.

Conduit: Usually a metal pipe in which electrical wiring is installed.

Contemporary Architecture: Modern or functional design, as distinguished from the traditional or stylistic.

Contiguous (Abutting): To touch upon, border upon, in physical contact, touching near or adjoining. A term used to describe the relative position of lots or parcels of land.

Counter Flashing: A barrier used on chimneys at roofline to cover shingle flashing and to prevent moisture entry.

Crawl Space: Distance between ground level and the first floor of a structure built on a foundation. (18" minimum height.)

Cul-De-Sac: (French: "bottom of sack") A street open at one end only; a dead-end street; a blind alley.

Deck: Usually an open porch on the roof, or on a ground or lower floor, porch or wing.

Dry Rot: A fungus decay causing seasoned lumber to become brittle and crumble to powder. Of all the woods, redwood is the least susceptible to this condition.

Dry Wall: A wall constructed with dry panels of plywood, fiberboard, gypsum board, etc., which are nailed to the studs, as opposed to a wet or plastered wall.

Eaves: The lower part of a roof projecting over the wall.

EER: When an air conditioning unit has a higher energy efficiency ratio (EER), it means that the unit is more efficient.

Expandable House: Home designed for further expansion and addition in the future.

Expansion Joint: A bituminous fiber strip used to separate units of concrete to prevent cracking due to expansion as a result of temperature changes.

Facade: Front of a building.

Fire Stop: A solid, tight closure of a concealed space, placed to prevent the spread of fire and smoke through such a space.

Flashing: Sheet metal or other material used to protect a building from seepage of water.

Footing: The base or bottom of a foundation wall, pier, or column.

Foundation: The supporting portion of a structure below the first-floor construction, or below grade, including the footings.

Front Foot: Property measurement for sale or valuation purposes; the property measured by the front foot on its street line width. Usually used for commercial lots and special tax assessments.

Frost Line: The depth of frost penetration in the soil. Varies in different parts of the country. Footings should be placed below this depth to prevent movement.

Furring: Strips of wood or metal applied to a wall or other surface to even it, to form an air space, or to give the wall an appearance of greater thickness.

Gable Roof: A pitched roof with two sloping sides.

Gambrel Roof: A curb roof, having a steep lower slope with a flatter upper slope above.

Girder: A large beam used to support beams, joists and partitions.

Grade: Ground level at the foundation.

Header: A framing member, usually of one or more pieces of lumber, placed over an opening in a wall.

Hip Roof: A pitched roof with sloping sides and ends.

Indirect Lighting: The light is reflected from the ceiling or other object external to the fixture.

Jamb: The side post or lining of a doorway, window or other opening.

Joint: The space between the adjacent surfaces of two components joined and held together by nails, glue, cement, mortar, etc.

Joist: One of a series of parallel beams to which the boards of a floor and ceiling laths are nailed, and supported, in turn by large beams, girders, or bearing walls.

Kiosk: A freestanding booth in a parking lot or a shopping mall. Film processing booths and key shops located in these areas are examples of kiosks.

Lath: A building material of wood, metal, gypsum, or insulating board fastened to the frame of a building to act as a plaster base.

Legal Description: A written description by which property can definitively be located by reference to government surveys or approved recorded maps.

Lintel : A horizontal board that supports the load over an opening such as a door or window. Can also be metal, if supporting brick or masonry. Similar to a “header.”

Live Load: Floor joists are required to support a live load of at least 40 pounds per square foot, and a roof must support a live load of at least 20 pounds per square foot.

Louver: An opening with a series of horizontal slats set at an angle to permit ventilation without admitting rain, or sunlight.

Megalopolis: A Greek word meaning “great city.” The dictionary describes it as an extensive, heavily populated, continuously urban area, including any number of cities.

Metes and Bounds: A type of legal description, of a parcel of land which identifies the boundaries of the parcel.

Minimum Areas: In every dwelling at least one room must have no less than 120 square feet of superficial floor area. Every other habitable room except the kitchen or breakfast room must have 90 square feet of floor area.

Molding: Usually patterned strips used to provide ornamental variations of outline or contour, such as cornices, bases, window and door jambs.

Monument: A fixed object and point established by surveyors to establish land locations.

Overhang: The part of the roof extending beyond the walls to shade buildings and cover walks.

Parquet Floor: Hardwood flooring laid in squares or patterns.

Party Wall: A wall erected on the line between two adjoining properties which are under different ownership, for the use of both properties. Example: a fence, which both “parties” use.

Penny: Size of nails such as one-penny, three penny, etc.

Pier: A column of masonry, usually rectangular in horizontal cross section, used to support other structural members.

Pitch: The incline or rise of a roof (4" to every foot for wood shingles.) Pitched roofs last longer than flat roofs.

Plat: A map or plan of a certain parcel of land.

Plat Book: A book showing the lots and legal subdivisions of an area.

Plate: A horizontal board placed on a wall or supported on posts or studs to carry the trusses of a roof or rafters directly; a shoe, or base member as of a partition or other frame; a small flat board placed on or in a wall to support girders, rafters, etc.

Prefabricated House: A house manufactured and sometimes partly assembled, before delivery to building site.

Purlin: A piece of timber laid horizontally to support the common rafters of a roof.

Quarter Round: A molding that presents a profile of a quarter circle.

Radiant Heating: A method of heating, usually consisting of coils or pipes placed in the floor, wall, or ceiling.

Rafter: One of a series of boards on a roof designed to support roof loads. The rafters of a flat roof are sometimes called roof joists.

Range: A strip of land six miles wide, as determined in the U.S. Government Survey, which runs north and south and which is parallel to meridian lines used in the survey system.

Ridge: The horizontal line at the junction of the top edges of two sloping roof surfaces. The rafters at both slopes are nailed at the ridge.

Ridge Board: The board placed on edge at the ridge of the roof to support the upper ends of the rafters; also called roof tree, ridge piece, ridge plate and ridge pole. Highest board in a wood frame house.

R Rating: A system which has been developed by authorities to measure the relative ability of building insulation materials to resist cold and/or to retain heat. R9, R15, R19, etc., are examples of these ratings. The higher the number, the greater the protection.

Sash: Wood or metal frame containing one or more window panes.

Scribing: Fitting woodwork to an irregular surface.

Shake: A hand split wood shingle.

Sheathing: Structural covering usually boards, plywood, or wallboards, placed over exterior studding or rafters of a house.

Sill: The lowest part of the frame of a house resting on the foundation and supporting the uprights of the frame (studs). The board or metal forming the lower part of an opening, as a door sill, window sill, etc.

Soil Pipe: Pipes carrying waste out from the house to the main sewer line.

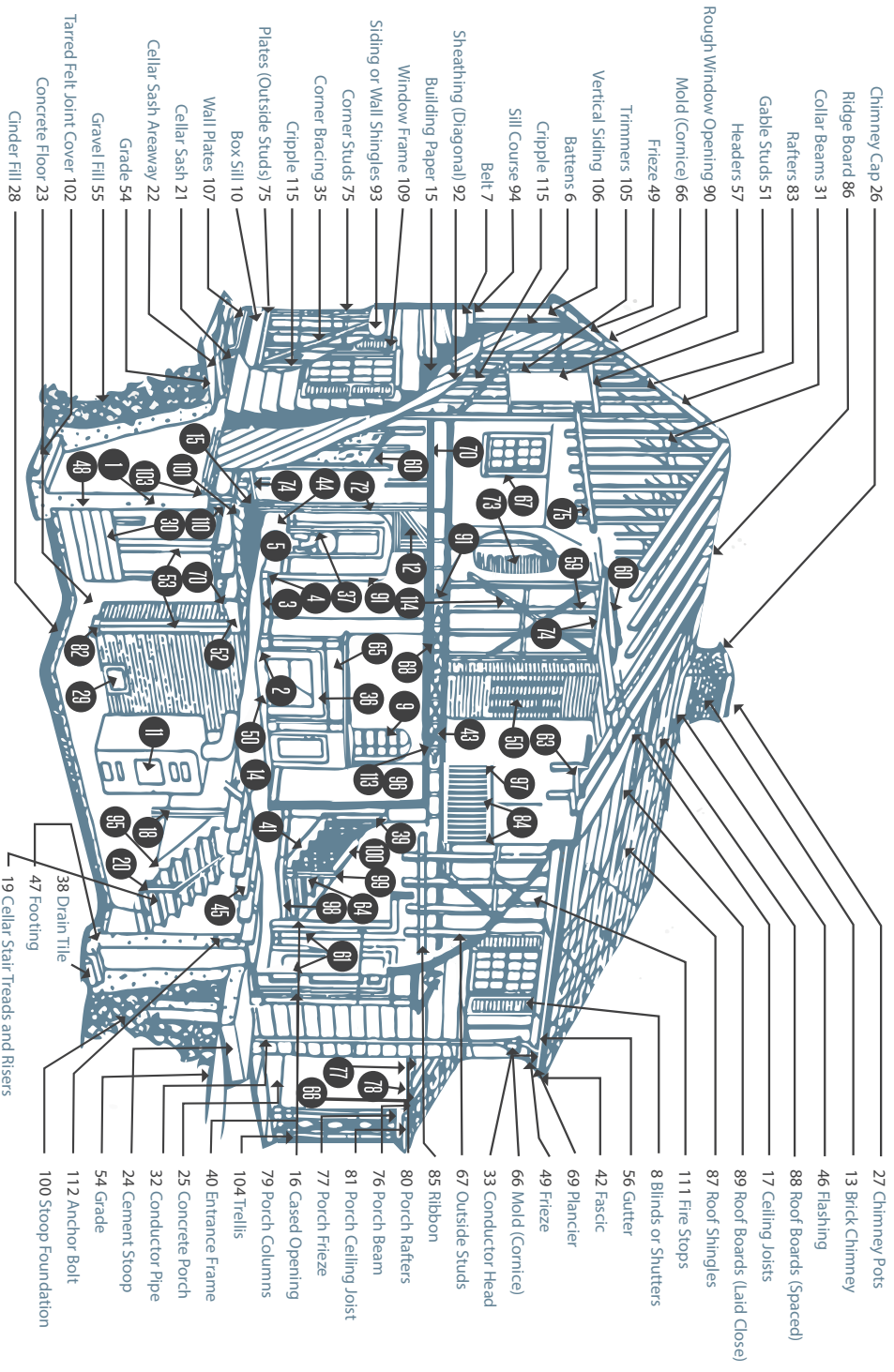
Sole or Sole Plate: A member, usually a 2" x 4" on which wall and partition studs rest.

Studs: Vertical structural lumber, normally 2" x 4" x 8' used in framing a building, usually required to be not more than 16 inches from center to center.

Survey: method of determining the boundaries of a parcel to provide a legal description. A correct survey must contain a definite point of beginning and definite tract or parcel corners, specific length and directions of the sides of the property and the area within the boundaries in accepted units of measure

Tier: A strip of land six miles wide, as determined by the U.S. Government Survey, which runs east and west and which is parallel to the base lines used in the survey system (Township Lines).

Township: In the survey of public lands of the United States, territorial subdivision six miles long, six miles wide and containing 36 sections, each one-mile square, located between two range lines and two township lines.



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- 2. Ash Dump
- 3. Base
- 4. Base Mold
- 6. Base Shoe
- 9. Book Shelves
- 11. Boiler
- 12. Bracing
- 14. Bridging
- 16. Building Paper
- 18. Cellar Stair Post
- 20. Cellar Stair Rail & Post
- 29. Cleanout Door
- 30. Coal Bin Partition
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- 43. Finish Floor - 1 - 2 Strips
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- 45. First Floor Joists
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- 74. Plates (Inside Studs)
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- 112. Anchor Bolt
- 100. Stoop Foundation
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- 86. Ridge Board
- 31. Collar Beams
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- 90. Rough Window Opening
- 66. Mold (Cornice)
- 49. Frieze
- 105. Trimmers
- 106. Vertical Siding
- 6. Battens
- 115. Cripple
- 94. Sill Course
- 7. Belt
- 92. Sheathing (Diagonal)
- 15. Building Paper
- 109. Window Frame
- 93. Siding or Wall Shingles
- 75. Corner Studs
- 35. Corner Bracing
- 115. Cripple
- 75. Plates (Outside Studs)
- 10. Box Sill
- 107. Wall Plates
- 21. Cellar Sash
- 22. Cellar Sash Acreway
- 54. Grade
- 55. Gravel Fill
- 102. Tarred Felt Joint Cover
- 23. Concrete Floor
- 28. Cinder Fill
- 2.7 Chimney/Pots
- 1.3 Brick Chimney
- 4.6 Flashing
- 8.8 Roof Boards (Spaced)
- 1.7 Ceiling Joists
- 8.9 Roof Boards (Laid Close)
- 8.7 Roof Shingles
- 1.1.1 Fire Stops
- 8. Blinds or Shutters
- 5.6 Gutter
- 4.2 Fascia
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- 3.3 Conductor Head
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- 5.4 Grade
- 1.1.2 Anchor Bolt
- 1.0.0 Stoop Foundation

Hip Roof



Georgian Colonial

Gambrel Roof



Dutch Colonial

Hip Roof



Spanish

Gable Roof



New England Colonial

Gable Roof



Southern Colonial

Gable Roof



Monterey

Compound Gable Roof



California Ranch

Gable Roof



Cape Cod

Compound Gable Roof



California Bungalow

Land Descriptions

Legal descriptions usually fall into one of three general categories:

1. A **government survey** in which the description refers to section, township and range.
2. A running description outlining the boundaries of a parcel of land called **metes and bounds** (used in describing irregularly shaped parcels).
3. Reference to a recorded map, usually used in describing land subdivided into lots, known as a **lot book** description.

Legal descriptions are necessary in any instrument to be recorded that affects the transferability of the title to real property (e.g., deeds, mortgages and trust deeds, easements, etc.). Instruments that are not needed by a title insurance company, such as property tax statements, often do not call for a complete legal description.

Section, Township, and Range

Land in the United States is surveyed into tracts bounded by lines conforming to the true meridian. The largest of these tracts is called a **township**. A township is six square miles, established to reference a principal baseline on a true parallel of latitude and to a longitude called principal meridian. Each tract contains 36,000 acres. Each row of townships running north and south parallel to a true meridian is called a **range**. Each row of townships running east and west parallel to the principal baseline is called a **tier**.

While the government survey system of describing land gives a uniform system of land description in this country, every township might not have the same land area. Adjustments in land area must be made because of the curvature of the earth. This results in what are identified as fractional sections in certain townships. These fractional sections occur where a correction is made. The land in a township may vary above or below the standard 36,000 acres. The practice in surveying a township is to apportion any excess or deficiency to the sections on the north and west sides of the township. Thus, the total possible fractional sections would be 11—six along the northern boundary and five along the western boundary. Section six could be corrected on both units, the north and west sides.

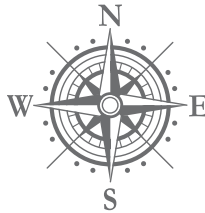
It should be noted that the range markers always run north and south paralleling the principal meridian, yet they are numbered east or west of the principal meridian. The tiers always run east and west, yet they are numbered north or south of the baseline.

In a U.S. government survey land description, the tiers of townships bear numbers in relation to baselines either north or south of them, and the ranges bear numbers in relation to the principal meridian lines either east or west of them.

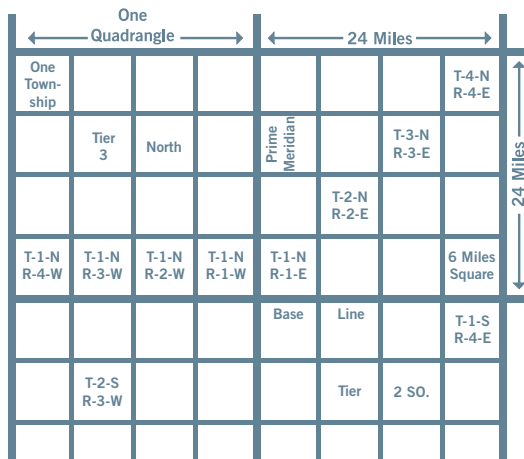
Government surveys start from points where the baselines cross the meridian lines. In California, there are three such points:

1. In Northern California, it is the **Humboldt Baseline and Meridian**.
2. In Central California, it is the **Mount Diablo Baseline and Meridian**.
3. In Southern California, it is the **San Bernardino Baseline and Meridian**.

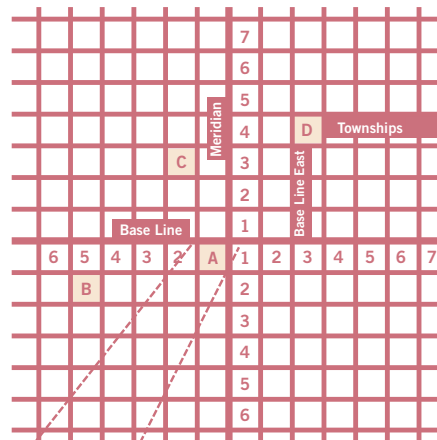
Townships are divided into 36 squares or tracts, each one-mile square and each containing 640 acres, known as a section of land. This is the smallest division required by law to be actually surveyed. The minor subdivisions are designated by lines dividing the sections into four quarters of 160 acres each, and these quarters are in turn divided into four quarters of 40 acres each (nearly all township maps are divided into 40-acre tracts). Although the section is the smallest division surveyed by the government, the smaller tracts are contemplated by law and are accomplished by running true lines from one established point to another, both east and west and north and south.



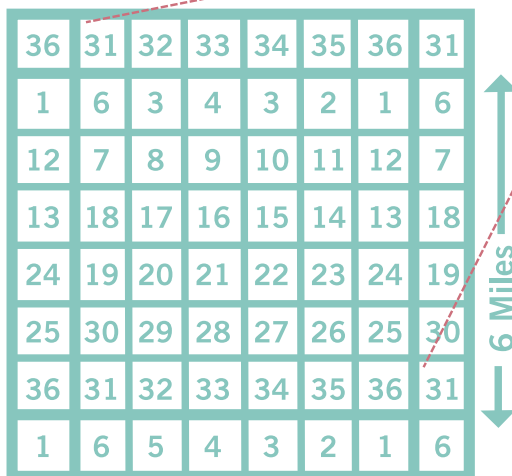
Base & Meridian Lines: Figure A



Townships: Figure B



Township 1 South (In Range 1 West)
Figure C

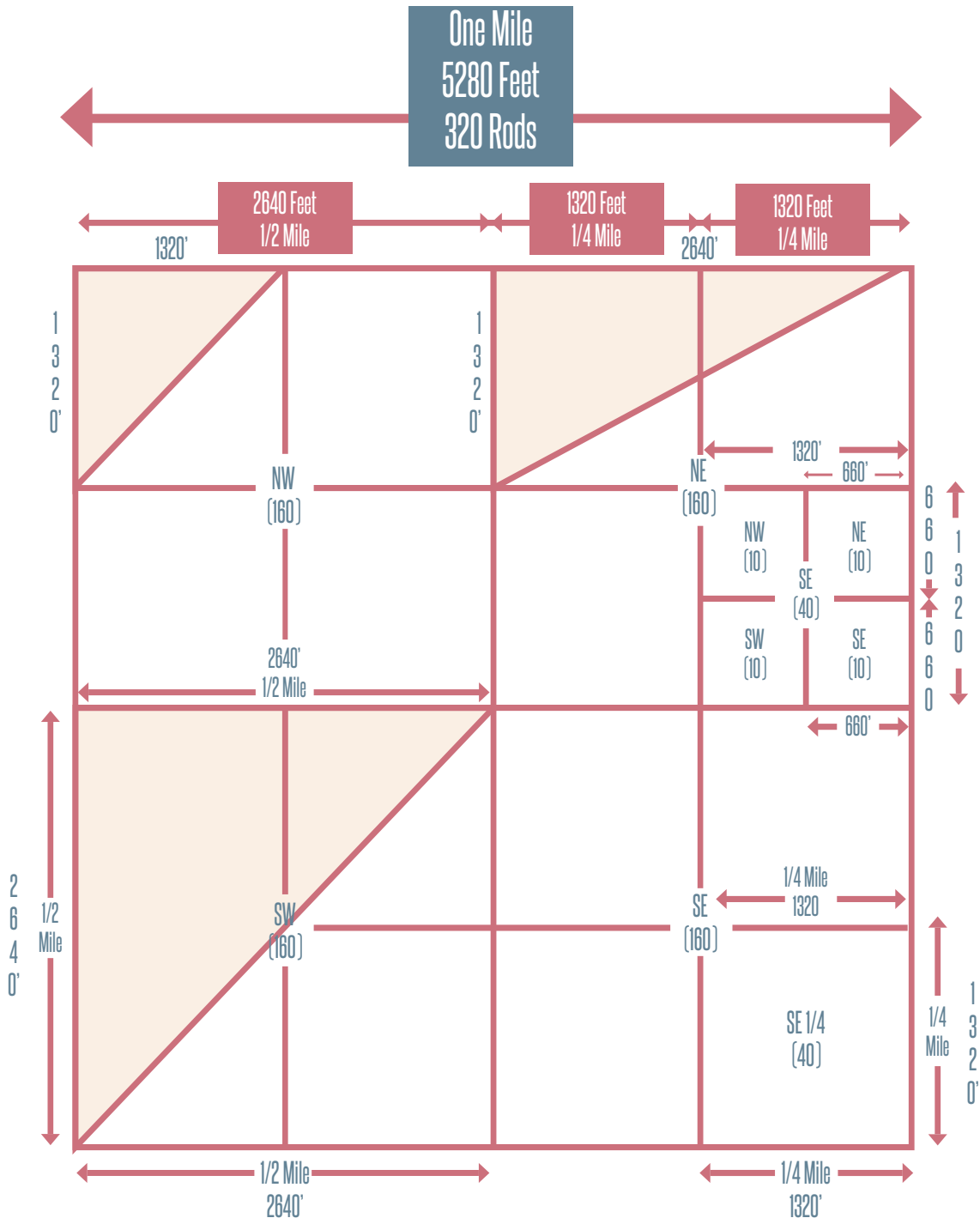


Sectional map of Township

Figure D



State of California



1 township contains 23,040 acres
 640 acres 1 square mile
 160 acres = 1/2 mile square
 1 township contains 36 square miles
 1 township contains 36 sections
 1 section contains 640 acres
 1 section is one mile square
 1 section contains one square mile

5,280 feet 1 mile
 80 chains = 1 mile
 1 chain = 66 feet
 1 chain = 4 rods
 320 rods = 1 mile
 160 acres = 1/4 of a section
 43,560 square feet = 1 acre
 9 square feet = 1 square yard
 27 cubic feet = 1 cubic yard

Metes and Bounds

Metes and bounds simply means “the measurement of the boundaries.” It is usually used in the description of irregularly shaped parcels and always begins with a north or south direction from the starting point. The original settlers in California described their property using natural boundaries (rivers or streams) and monuments (piles of rocks). This form of description, compared to United States government survey, is less desirable because the streams can change their course and the monuments can be destroyed or removed. Most of these original descriptions have since been converted to government surveys.

The seaward boundary of an ocean front lot is the mesne (average) high tide line.

Note: To determine acreage in metes and bounds descriptions for irregularly shaped parcels, you must remember that a diagonal line cuts any square or rectangle in half. You square up the diagonal line (the whole line, not just a portion of it). Now you need only to count the number of acres in the squared-up area and divide by two. The following two parcels contain 40 acres (left) and 120 acres (right). How much is in each triangle area?



Lot Book Description (Known as “Recorded Map”)

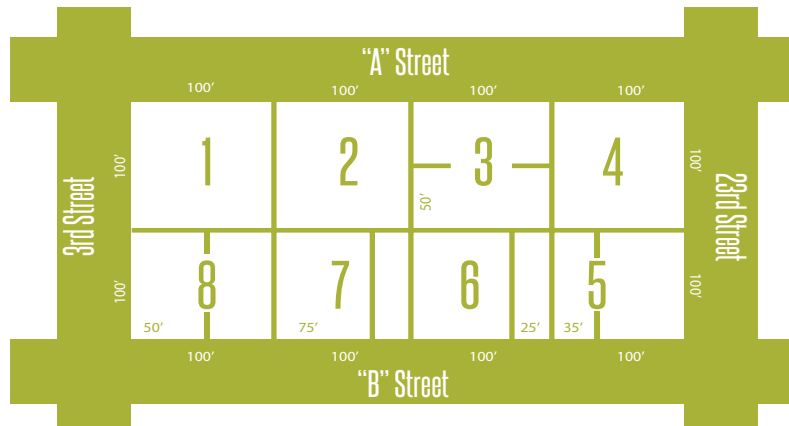
Lots sold from recorded maps carry a description referring to the map and giving the book and page number of the recordation. A typical description of this kind would be: Lot 7, Block B, Tract 6447, as recorded in Book 81, pages 100-105 of Maps, Records of Los Angeles County.

Lot Book descriptions may be by fractional description or by metes and bounds. Any type of description that is sufficient to locate a parcel of land, a lot, or a part of a lot, either on the county recorder’s books or in the field, is considered a good description. The less complicated it is, the better for all concerned. However, the record books are filled with wordy, detailed descriptions that a real estate broker or salesperson may be called upon to locate, so it is necessary to understand how to read them.

Fractional descriptions are used when the property can be described by a certain fraction of the lot, such as “the south twenty feet” or “the east one-half.” A whole lot and a portion of another would be described as “All of Lot 1, and the east one-half of Lot 2” followed by the Lot Book description locating it in the county records. Such descriptions are not possible where the lot is irregular in shape. These must be described by metes and bounds. Regularly shaped lots may also be described by metes and bounds, but a fractional description is less complicated and the simplest method is usually the best.

A typical fractional description problem might read like this:

Below is a portion of the Smith Tract, Lots 1 to 8 as recorded in Book 72, pages 1314, Maps and Records of Los Angeles County. Describe the various parcels. The correct legal description of each of the three parcels below:

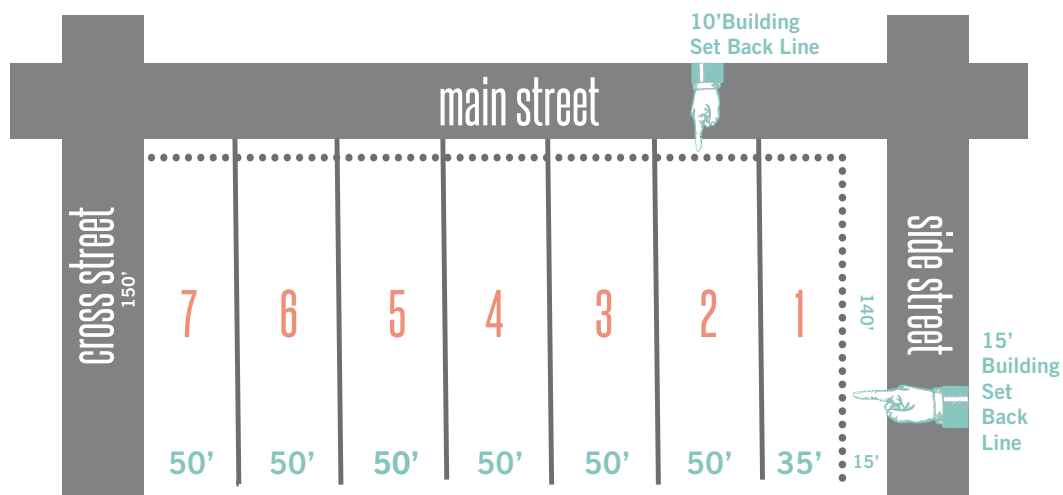


1. The east 1/2 of Lot 8 of the Smith Tract, as recorded in Book 72, pages 13-14, Maps and Records of the Los Angeles County.
2. The east 25 feet of Lot 7 and the West 75 feet of Lot 6 of the Smith Tract, as recorded in Book 72, pages 13-14, Maps and Records of Los Angeles County
3. The north 50 feet (or the N-1/2) of Lot 3, all of Lot 4, and the east 65 feet of Lot 5, of the Smith

Tract, as recorded in Book 72, pages 13-14, Maps and Records of Los Angeles County.

Building Setback Lines and Linear Foot Calculations

To preserve a view, or for other purposes such as uniformity in the placement of buildings on the various lots fronting upon a street, deed restrictions and city or county building ordinances usually contain a provision that the house or other structure be set back a certain distance from the lines of the lots. Thus, every time a building is constructed, the builder is forced by law to keep the substantial parts of the structure within the setback lines scheduled for that particular lot, as illustrated below.



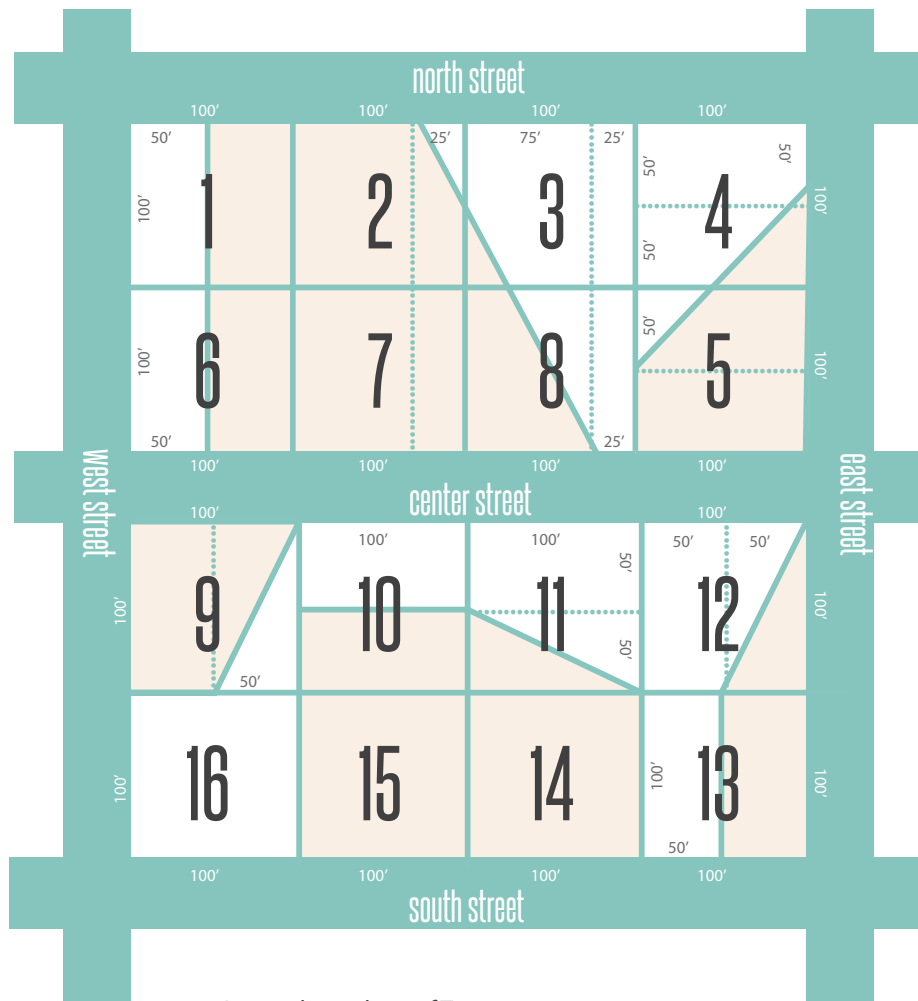
It must be clearly understood that although the purchaser of a lot is restricted by the setback lines as to the area upon which he may erect a structure, he must purchase the entire lot.

Question: If the builder of this subdivision decided to cement over the setback line as a sidewalk area, what would the linear footage be for both Main and Side Streets?

This is one of the most often-missed state examination questions. Normal thought states that there are 7 lots, each 50' wide, and therefore there would be 7 X 50' or 350 feet on Main Street. Since the lots are 150' deep, there would be 150 linear feet on Side Street (350' + 150' = 500 linear feet).

Wrong! This overlaps the corner. If there are 350 linear feet on Main Street, then the linear feet on Side Street can only be 140 linear feet. It must butt up against the sidewalk already laid. The true answer is 350 linear feet on Main Street and 140 linear feet on Side Street = 490 total linear feet.

The following map shows the pre-subdivision of lots into 5 irregularly shaped parcels that can only be described by metes and bounds. We are not concerned with the description of these parcels. In a state examination, you must be able to answer correctly, by multiple choice, the square footage of each.



Lots 1 through 16 of Tract 1147, as per map recorded on Page 64, Book 27, Official Maps and Records of the County of Los Angeles, State of California

Questions:

1. How many square feet are there in the shaded area of Lots 1-2-3-6-7 and 8?
2. How many square feet are there in the shaded area of Lots 4 and 5?
3. How many square feet are there in the shaded area of Lot 9?
4. How many square feet are there in the shaded area of Lots 10-11-14 and 15?
5. How many square feet are there in the shaded area of Lots 12 and 13?

Answers to 5 Irregularly Shaped Parcels

1. Divide the entire parcel into two separate areas as shown by the dotted line running vertically through Lots 2 and 7. To the west (left) is a rectangular area 125' wide by 200' deep containing 25,000 square feet. To the east (right) is a triangular area. "Square up" the diagonal line as shown by the dotted line running vertically through Lots 3 and 6. This becomes a rectangular parcel 100' wide by 200' deep containing 20,000 square feet. One-half of this, or 10,000 square feet, is in the shaded area. 25,000 square feet added to 10,000 square feet gives us 35,000 square feet.
2. Divide the described parcel into two separate areas as shown by the dotted lines running horizontally through Lots 4 and 5.

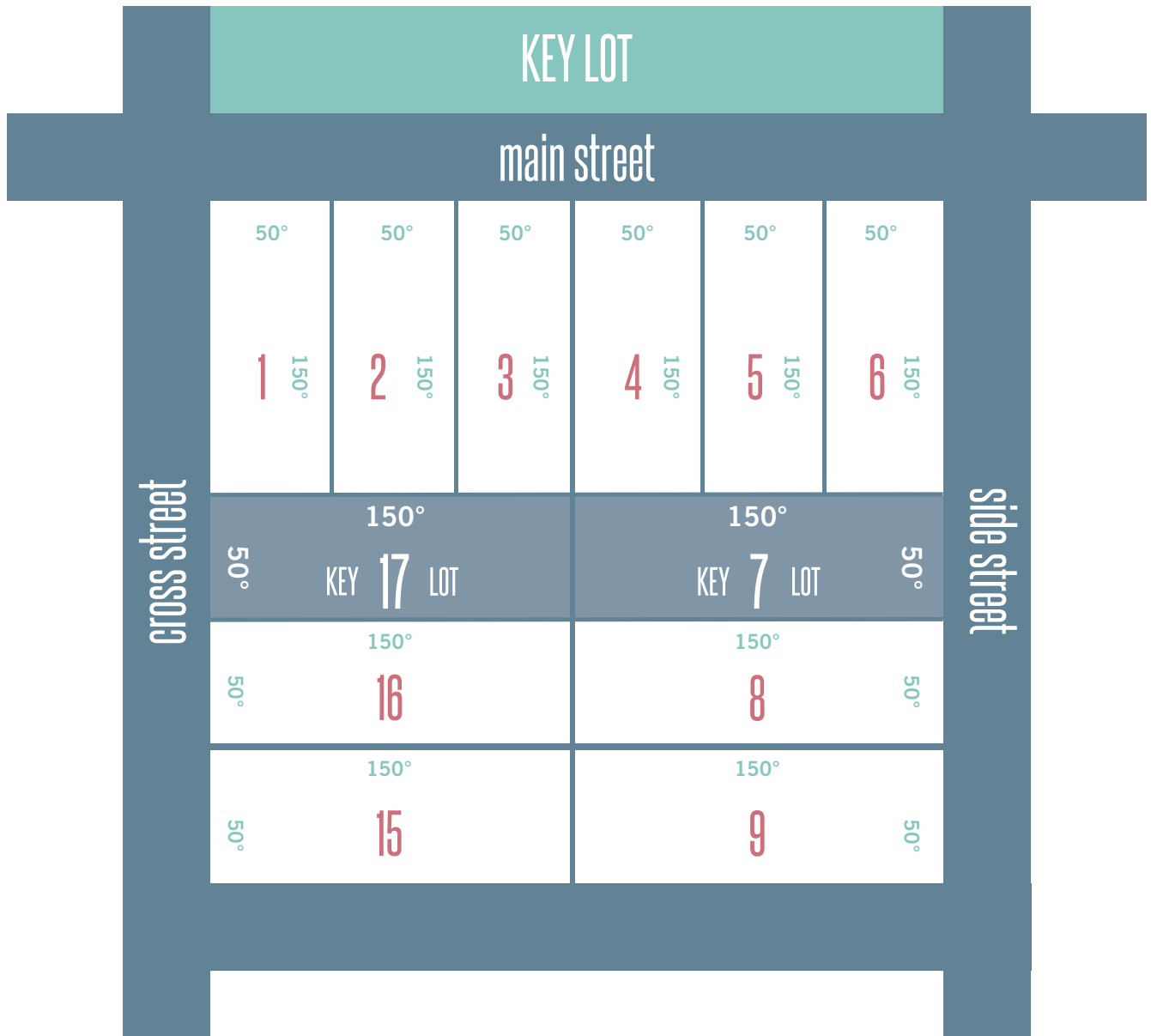
To the north is a square area 100' x 100' containing 10,000 square feet. The shaded area is only one-half of that amount, or 5,000 square feet. The area to the south is a rectangular parcel 50' x 100' which contains 5,000 square feet.

Hence, 5,000 square feet plus 5,000 square feet equals 10,000 square feet of area.
3. Divide the parcel into two separate areas as shown by the dotted line running through Lot 9. To the left is a rectangular area 50' x 100' containing 5,000 square feet. To the right is a rectangular area of the same square footage, 5,000 square feet, but only one-half of the area is shaded, which would be 2,500 square feet. Hence, 5,000 square feet plus 2,500 square feet equals a total area of 7,500 square feet.
4. Lots 14 and 15 are completely shaded. They are both 100' x 100' which is 10,000 square feet in each lot. The shaded area of Lot 10 is one-half the size of the entire lot, which would be 5,000 square feet. "Square" one-half of Lot 11 (with the dotted line) to find a total area of 5,000 square feet. The shaded portion is one-half of the total, or 2,500 square feet. To summarize, 10,000 square feet plus 10,000 square feet, plus 5,000 square feet, plus 2,500 square feet totals 27,500 square feet.
5. Using the dotted line, "square up" the area described in Lot 12. The total area is 50' x 100' or 5,000 square feet. The shaded portion is one-half of the total or 2,500 square feet. In Lot 13 there is a parcel 50' x 100' or 5,000 square feet shaded. Hence, 5,000 square feet plus 2,500 square feet will total 7,500 square feet.

Key Lot

A **key lot** is a lot that is bounded on one of its sides by the rear end of lots that front on another street.

A key lot is the least desirable lot in a subdivision because a person living on a key lot has the back yard of his neighbor at the side of his house. If the key lot backs up to a business, then the one living there has the unsightly rear view of a business property alongside the front yard.



Cul-De-Sac

A cul-de-sac is a street open at one end only—a dead end street. Cul-de-sacs are created in modern subdivision practice to help form curving streets and more private play areas. Living on a cul-de-sac prevents any through traffic and provides, in most cases, a more pleasant living experience.

The Arithmetic of Real Estate

A grade-school level of education in arithmetic is all that is required to compute the problems encountered in most real estate transactions. Addition, subtraction, multiplication, long and short division present no difficulty to the average student, but some students may have forgotten the rules for using these basic subjects in solving problems related to percentage, reducing fractions to decimals, and the placing of the decimal point.

Obviously, we cannot undertake to give complete instruction to the student who lacks education in primary arithmetic, but perhaps a review of some of the fundamentals concerning decimals will be helpful in recalling rules and formulas that, from long disuse, have been forgotten.

Fractions most commonly used in real estate concern percentage, such as $6\frac{1}{4}\%$ or $6\frac{1}{2}\%$. You may have seen a percentage written as 7.1% or 7.8% and verbally expressed as “seven point one percent” or “seven point eight percent.”

When a number is followed by a “%” sign, it indicates that it is not a whole number, but represents a certain part or “percent” of a whole number. To make it easier to multiply and divide by such numbers, they are usually reduced to decimals.

To reduce any number followed by a “%” sign to a decimal, place a decimal point two places to the left. Thus, $6\frac{1}{4}\%$ is written as .0625; $6\frac{1}{2}\%$ as .0650; 7.1% as .071; and 7.8% as .078.

The location of the decimal point determines the value of a number. Those to the left of the decimal point are whole numbers; those to the right of the decimal point are parts of whole numbers.

The decimal system is based on the use of multiples of ten. Moving the decimal point one place to the right multiplies the figure by 10; moving it two places to the right multiplies the figure by 100; and moving it three places to the right multiplies the figure by 1000.

In reverse, moving the decimal point one, two, or three places to the left decreases the value of the number in the same proportion.

The U.S. money system is a good illustration of decimals. The dollar is the basis of the system and stands for 100 units or cents, with each unit or cent being one hundredth part, or 1% of a dollar, and is written \$.01. If you have one dollar and twenty-five cents, it is written \$1.25, with the number to the left of the decimal point indicating one whole dollar, and the number to the right indicating 25 parts of a dollar. In fractions, twenty-five cents would be $\frac{1}{4}$ of a dollar. Fifty cents would be $\frac{1}{2}$ of a dollar, written \$.50. Seventy-five cents is $\frac{3}{4}$ of a dollar, written \$.75.

When using your calculator, always set the decimal point to reach as many places following the decimal point as possible. Examinations often want four or more places after the decimal point.

Addition of Decimals

With a calculator, you simply keep adding each number (always putting in the decimal point) until you reach the last number. Then, you hit the (total) or (=) key, and you have your answer.

Example 1. Add $.625 + .3325 + .50 = 1.4575$

Example 2. Add $17.254 + 1.35 = 18.604$

Subtraction of Decimals

With a calculator, you add the numbers given and subtract the numbers given (always putting in the decimal point). When you reach the last number, you hit the (total) or (=) key and you have your answer (view it as you go).

Example (using your calculator): Subtract 8.0276 from 11.37.

Solution: (input) $11.37 (-) 8.0276 =$ (total key), or simply view your answer.

Problem: Subtract .37254 from 1.2675

Solution: (input) $1.2675 (-) .37254 = .89496$

Multiplication of Decimals

Problem: Multiply .927 by .56

Solution: $.927 \times .56 = .519132$ (rounded off .51913)

Practice Problems

Work the following problems to see if you arrive at the correct answers, as shown.

- A. $.35 \times 4$ (1.40)
- B. $.785 \times 25$ (19.625)
- C. $.287 \times .356$ (.102172)
- D. $.002 \times .014$ (.000028)
- E. 1.0034×2.503 (2.5115102)
- F. 32.25×2.376 (76.62600)

Division of Decimals

1. **Problem:** Divide 82.57 by .27

Solution: $82.57 \div .27 = 305.814$

2. **Problem:** Divide 987.26 by 4 then divide the answer by 2

This problem can only be answered by doing two parts on your calculator:

Solution: Step One - $987.26 \div 4 = 246.815$

Step Two - $246.815 \div 2 = 123.4075$

Practice Problems

Work the following problems to see if you arrive at the correct answers, as shown:

- A. Divide 3.036 by .06 (50.6)
- B. Divide 3.728 by .16 (23.3)
- C. Divide .864 by .024 (36)
- D. Divide 10.044 by .36 (27.9)
- E. Divide .125 by 8000 (.0000156+)
- F. Divide 2.34 by .211 (11.09+)
- G. Divide 12 by .7854 (15.27+)

Factors In Percentage Problems

Before working any arithmetic problem, it is important that you analyze it carefully to determine and identify the factors involved so that you can apply the proper formula for solution. There are three such factors in every percentage problem. You must learn to identify them. The three factors are:

1. The amount earned or the amount Made.
2. The amount invested or the amount Paid.
3. The rate of return or the Percent (%) of return.

For simplification, we shall call these factors Made, Paid and Percent (%).

Rules for Percentage Problems

The percentage problem arises when one of the three factors is missing and we are asked to find it. The three simple rules for finding the missing factor are:

1. To find amount Made: Multiply Paid by %
2. To find amount Paid: Divide Made by %
3. To find %: Divide Made by Paid



Directions:

To find Made, cover the word Made and do the remaining problem.

To find Paid, cover the word Paid and do the remaining problem.

To find Percent (%), cover the % sign and do the remaining problem.

Other terms for Made, Paid, and Percent (%) (always annual):

Made	Paid	%
Return	Investment	Rate of Return
Profit	Cost	Rate of Profit
Commission	Price	Rate of Commission
Net income	Value	Rate of Capitalization (Cap Rate)
Interest	Principal	Rate of Interest

Identifying the Factors and Using the Rule

Let us see how these rules work with some very simple problems.

1. **Problem:** Find the amount earned (Made) by an investment of \$1,000 at 6% per annum. Here, we have the factors of investment (Paid) and Percent (%).

Cover the missing factor:

Paid
x% Made

Solution: (using your calculator) $1000 \times .06 = 60.00$ (\$60.00)

2. **Problem:** \$60 is 6% of what amount?

First, we identify the factors present. The missing one is our problem. Here it is evident that \$60 is the amount earned (Made) at the rate of 6% (%). The missing factor is the amount invested (Paid)

Cover the missing factor:

Paid
x% Made

60 divided by .06 = 1000 (Paid) (\$1,000)

3. **Problem:** What is the rate of interest on an investment of \$1,000 showing a return of \$60.00 per year?

Here, the factors present are the amount invested (Paid) and the amount earned (Made).

We have to find Percent (%).

Cover the missing factor:

Paid
x% Made

Divide Made by Paid to get Percent (%).

60.00 divided by $1000.00 = .06$ or 6%

Types of Problems - Finding the Amount Made

1. **Problem:** A man bought a building for \$800,000 and received a 6% annual return on his investment. What amount of money did he receive each year?

In this case, we have the factors of investment (Paid) and the percentage of return on the investment (%). We are looking for Made.

Cover the missing factor:



Multiply Paid by Percent (%) to find Made

$$800,000 \times .06 = 48,000.00 \text{ (\$48,000) dollar return received each year}$$

2. **Problem:** Assume that the tax rate is 1.125% of the assessed value (taxable value) of the property, which is \$600,000. Calculate the amount of the property taxes due on this property.

Change the tax rate stated as a percentage to a decimal by moving the decimal point two places to the left. Thus, 1.125% becomes .01125.

You now have Paid (\$600,000) and Percent (%) (.0125). You are looking for Made (the taxes).

Cover the missing factor:



Multiply the taxable value of the property by this decimal. In this problem, multiply 600,000 by .01125.

Solution: $600,000 \times .01125 = 6,750 \text{ (\$6,750)}$

3. **Problem:** A real estate salesperson sold a house for \$500,000 and received 60% of the total commission of 5% of the sales price. What did the salesperson receive?

In this case, we have the factors of sales price (Paid) and the commission percentage for the office and the salesperson Percent (%). What is Made? Apply Rule One to find Made.

Step One - Find the broker's commission

Cover the missing factor:



$$500,000 \times .05 (5\%) = \$25,000 \text{ Broker's Commission}$$

Step Two - Find the salesperson's share of the broker's commission.

Cover the missing factor:



$$25,000 \times .60 (60\%) = \$15,000 \text{ Salesperson's Commission}$$

4. **Problem:** A real estate broker negotiated a five-year lease at \$1650 per month and received a 5% commission on the total lease amount. What commission did the broker receive?

Cardinal Rule 1 - You must always work with the total amounts.

Before you can apply the correct rule, you must find the total lease amount.

Here we have the factor of total lease amount (Paid) and the percentage commission the broker is to receive (%). What is Made?

Step One - Find the total lease period (in months).

$$5 \text{ years: } 5 \times 12 \text{ months (per year)} = 60 \text{ months lease}$$

Step Two - Find their total lease amount.

$$60 \text{ (months)} \times 1,650 = 99,000 \text{ (Paid) Total Lease Payments}$$

Step Three - Find the broker's commission.

Cover the missing factor:



$$99,000 \text{ total lease (Paid)} \times .05 (5\%) = \$4950.00 \text{ Broker's Commission (Made)}$$

Types of Problems Finding the Amount Paid

1. **Problem:** We identify the factors of Made and Percent (%). We have to find Paid.

\$57.50 is 5% of what sum?

Cover the missing factor:

Paid
x% Made

57.50 divided by .05 (5%) 1150 (\$1,150)

2. **Problem:** A return of \$180 per month at 6% requires an investment of what sum?

Here we have the factors Made and Percent (%). But note that \$180 is a monthly figure.

Cardinal Rule 2 - Everything in real estate arithmetic must be worked on an annual basis.

Step One - 180 per month x 12 months = 2160 (The Annual Income)

Now you have Made (2160) and the % (.06). You must find Paid.

Cover the missing factor:

Paid
x% Made

Step Two - $2160 \div .06 = 36000$ (\$36,000)

3. **Problem:** An owner purchased a lot for \$200,000. She is selling through a broker for a price that will give her a 10% profit, plus sales expenses of \$99. This does not include the broker's commission. In other words, the lot must sell at a price high enough to give the owner \$220,099 net and give the broker 5% commission.

Here we are given the factor Made, which is the money for the owner. We have to find the Percent (%) of the sales price that this amount represents. Then we will discover the sales price of the lot (Paid).

Step One - Find the amount made by the owner. \$200,000 (Purchase price) + \$20,000 (10%) + \$99 (expenses) = \$220,099.

The sales price (Paid) will be 100% (the total of anything). We know the broker is to receive 5% of that price as commission. If this is so, it also means that the owner will receive the money that represents 95% of the sales price (100% - 5% = 95%). We have determined then that \$220,099 is 95% of what amount (Paid)?

Cover the missing factor:

Paid
x% Made

Solution: $220,099 \div .95$ (95%) = 231,683.15 (\$231,683.15)

4. **Problem:** Arthur acquired a parcel of real property for \$175,000. He is now listing it for sale with broker Doris. He wants to sell the property at a price that will return him all of his original investment together with a 40% profit, after he has paid Doris a 10% commission. The sales price in this instance would be approximately what?

Here we must apply two rules to find our answer. In the first place, we have the factors Paid and %. They are \$175,000 and 40% (.40) profit. We are looking for Made.

Cover the missing factor:

Paid
x% Made

$175,000 \times .40$ (40%) = 70,000 owner's profit (Made) (\$70,000)

$175,000 + 70,000 = 245,000$ money the owner wishes to receive. This does not include any commission for the broker.

At this point, we have the factor Made (\$245,000) and the % (90%), and we are seeking Paid (selling price), which is more than the amount the owner will receive.

The sales price we seek will be 100%. Of that sales price, we know the broker is to get 10%. It follows, then, that 100% (sales price) - 10% (broker's commission) = 90% (the seller's portion of the sales price).

Cover the missing factor:

Paid
x% Made

$245,000 \div .90$ (90%) = 272,222.22 (\$272,222.22) the sales price needed

Problems Requiring Finding of the Percentage (%)

1. **Problem:** An apartment house owner receives \$48,000 net income per year from his investment, which was \$600,000. What is the percentage return on his investment? We have the factors Paid and Made.

Cover the missing factor:

Paid
x% Made

$48,000 \div 600,000 = .08$ (8%) return

2. **Problem:** An investor purchases two 75-ft. lots for \$45,000 each. She later divides them into three lots 50 ft. wide and sells each for \$36,000. What was the investor's percentage of profit?

Step One - Find the original purchase price $45,000 \times 2 = 90,000$

Step Two - Find the sales price $36,000 \times 3 = 108,000$

Step Three - Find the profit $108,000 - 90,000 = 18,000$

Step Four - Now that we have the purchase price (Paid) and we have the profit (Made), we need to find the percentage (%).

Cover the missing factor:

Paid
x% Made

$$18,000 \text{ (Made)} \div 90,000 \text{ (Paid)} = .20 \text{ (20\%)}$$

3. **Problem:** A broker sold a building for \$385,000 and received a commission check of \$19,250. What commission percentage did the broker receive? Again, we have the factors Paid and Made.

Cover the missing factor:

Paid
x% Made

$$19,250 \div 385,000 = .05 \text{ (5\% commission)}$$

4. **Problem:** A man purchases a building for \$120,000. His gross income from this investment is \$23,000 per year. His annual expenses are \$11,000. What is the percentage return on his investment?

Step One - Subtract his expenses to get his net income $23,000 - 11,000 = 12,000$

We now have the factors Paid and Made.

Cover the missing factor:

Paid
x% Made

$$12,000 \div 120,000 = .10 \text{ (10\%)}$$

Multiple-Step Problems

1. **Problem:** A lender made a \$200,000 loan. The note had an 8% interest rate and a term of 20 years. The borrower paid 4 points to secure the loan and a prepayment penalty of 2% of the original principal. The monthly payments were \$1670. At the end of 5 years, the borrower decided to sell the property and pay off the loan. The average principal balance for the 5-year period was \$185,000. The gross earnings of the lender were most nearly:

- A. \$71,960
- B. \$72,800
- C. \$86,000
- D. \$92,000

Step One - Find the costs involved: 2% (payoff) + 4% (points) to obtain the loan = 6%. The loan is \$200,000. We look for Made.

Cover the missing factor:



$$200,000 \times .06 = 12,000 \text{ (\$12,000)}$$

Step Two - Find the interest (made) over a 5-year period.

Cover the missing factor:



$$200,000 \times .08 = 16,000$$

Step Three - Find the interest for 5 years: $16,000 \times 5 = 80,000$

Step Four - Add the profits together: $12,000 + 80,000 = 92,000$ Answer (D)

2. **Problem:** William Davidson borrows \$5,000. The interest rate on the note is 11% per annum. The note provides for equal monthly payments of \$51.61 over a period of 20 years. The following amount of the first payment is an amortization of the loan principal:
- A. \$5.78
 - B. \$11.56
 - C. \$25.85
 - D. \$43.12

Step One - Note is \$5,000 (Paid). Interest is 11% (%). Find the annual interest (Made).

Cover the missing factor:



$$5000 \times .11 = 550$$

Step Two - Find the monthly interest.

$$550 \div 12 \text{ months} = 45.83$$

Step Three - Find the principal paid.

$$51.61 \text{ (payment)} - 45.83 \text{ (interest)} = 5.78 \text{ (first month's amortization)}$$

3. **Problem:** Broker Gordon negotiated a lease for 3,000 square feet of warehouse storage space at a monthly rental of \$0.50 per sq. ft. Gordon's commission is 8% of the first year's gross rent. Gordon will receive:
- A. \$1,180
 - B. \$1,340
 - C. \$1,440
 - D. None of the above.

Step One - Find one month's rent.

$$3,000 \text{ sq. ft.} \times .50 \text{ cents per sq. ft.} = \$1,500 \text{ rent for 1 month}$$

Step Two - Find the annual rent.

$$\$1,500 \text{ (1 month rent)} \times 12 = \$18,000 \text{ gross rent 1 year}$$

Step Three - You now have Paid and %. Find Made.

Cover the missing factor:



$$\$18,000 \times .08 \text{ (8\%)} = \$1,440 \text{ commission on first year rent}$$

4. **Problem:** An apartment complex cost \$4,500,000. It brings in a net income of \$30,000 per month. The owner is making the following percentage of return on the investment:
- A. 7%
 - B. 8%
 - C. 11%
 - D. None of the above.

Step One - Find the total annual income: $30,000 \times 12 = 360,000$

Step Two - You now have Paid and Made. You are looking for %.

Cover the missing factor:



$$360,000 \div 4,500,000 = .08 \text{ (8\%)}$$

5. **Problem:** An investor purchased a vacant parcel of land by making a down payment of 20% of the appraised value of the lot. The balance of the payment was a straight note that called for interest-only payments of \$9,900 per year. The interest rate on the note was 11% per annum. The appraised value of the property was:
- A. \$ 90,000
 - B. \$112,500
 - C. \$108,000
 - D. None of the above.

Step One - Find the amount of the note.

You have (Made) 9900 and (%). You are looking for the total amount of the note.

Cover the missing factor:



$$\$9,900 \div 11 \% = \$90,000.$$

Step Two - Find the purchase price.

The investor made a down payment of 20% of the purchase price. The loan amounted to 80% of the purchase price.

Cover the missing factor:



$$90000 \div .80 = 112500 \text{ (\$112,500)}$$

Chapter 7 Summary

Legal descriptions usually fall into one of three general categories:

1. A **government survey** which refers to section, township and range.
2. Outlining the boundaries with a **metes and bounds** description.
3. A recorded map known as a **lot book** description

Recorded maps carry a description referring to the map and giving the book and page number of the recordation. Typically: Lot 7, Block B, Tract 6447, as recorded in Book 81, pages 100-105 of Maps, Records of Los Angeles County.

Metes and bounds simply means “the measurement of the boundaries.” It is usually used in the description of irregularly shaped parcels and always begins with a north or south direction from the starting point.

Land in the United States is surveyed into tracts bounded by lines conforming to the true meridian. The largest of these tracts is called a **township**. A township is six square miles, established to reference a principal baseline on a true parallel of latitude and to a longitude called principal meridian. Each tract contains 23,040 acres. Each row of townships running north and south parallel to a true meridian is called a **range**. Each row of townships running east and west parallel to the principal baseline is called a **tier**.

Government surveys start from points where the baselines cross the meridian lines. In California, there are three such points:

1. In Northern California - **Humboldt Baseline and Meridian**.
2. In Central California - **Mount Diablo Baseline and Meridian**.
3. In Southern California - **San Bernardino Baseline and Meridian**.

B.T.U. (British thermal unit) is a standard used for measuring heating and air conditioning capacity.

When an air conditioning unit has a higher energy efficiency ratio (**EER**), it means that the unit is more efficient.

A freestanding booth in a parking lot or a shopping mall is called a **kiosk**.

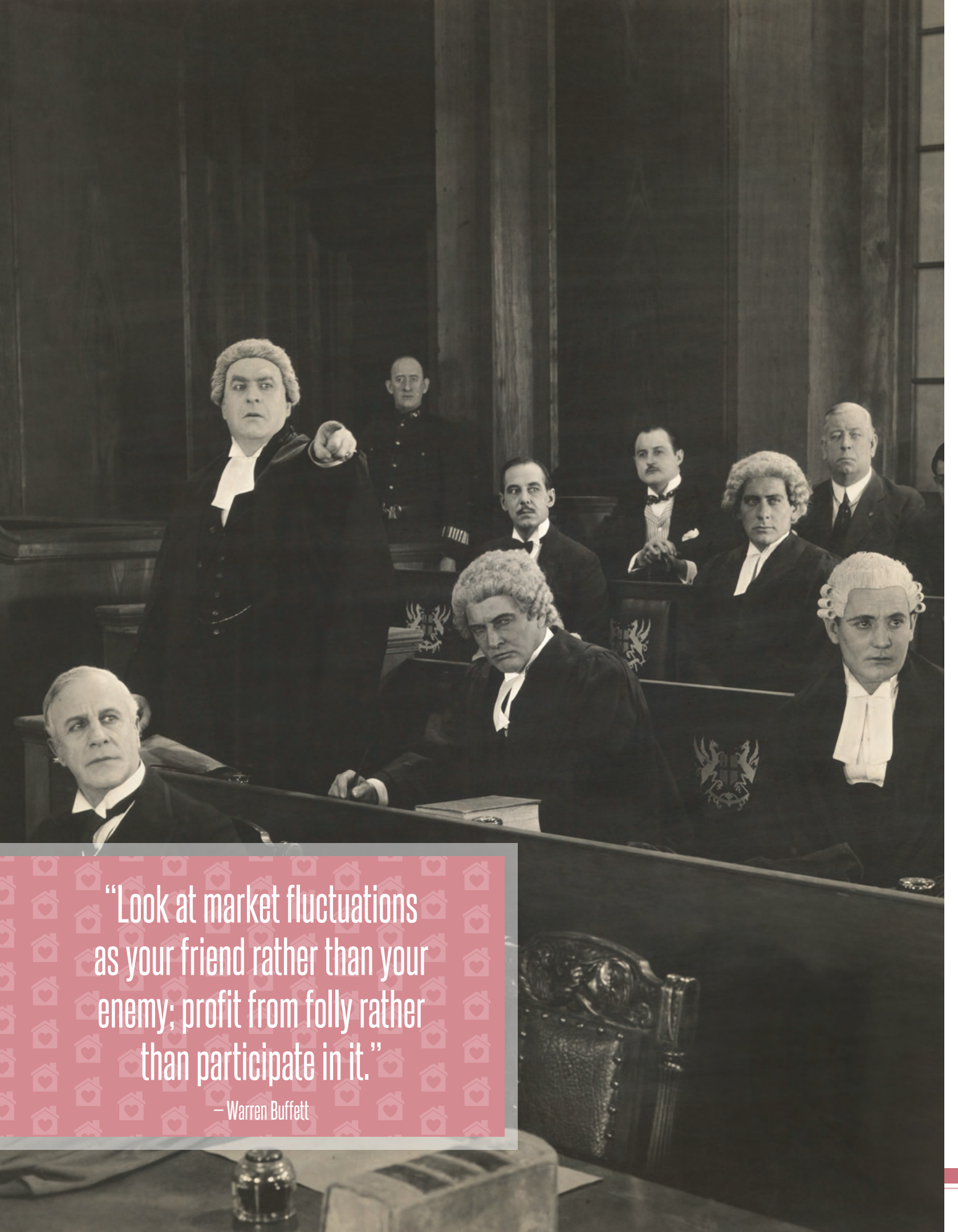
A **key lot** is a lot that is bounded on one of its sides by the rear end of lots that front on another street.

A **cul-de-sac** is a street open at one end only—a dead end street.

notes:

chapter 7 quiz

- 1. The person most apt to use a “bench mark” in the practice of his profession would be:**
 - a. Lawyer.
 - b. Carpenter.
 - c. General contractor.
 - d. Surveyor.
- 2. In California the minimum crawl space in a structure, as required by the building codes, is:**
 - a. 16 inches.
 - b. 18 inches.
 - c. 20 inches.
 - d. 24 inches.
- 3. When an air conditioning unit has a higher energy efficiency ratio (EER), it means that:**
 - a. The unit is less efficient.
 - b. The unit is more efficient.
 - c. It needs more watts of electricity.
 - d. The BTU's are larger.
- 4. One of a series of parallel beams to which the boards of a floor and/or ceiling laths are nailed would be a:**
 - a. Joist.
 - b. Rafter.
 - c. Stud.
 - d. Brace.
- 5. A kiosk is:**
 - a. Type of residential roof.
 - b. Parallel beam to which boards of a floor or ceiling laths are nailed.
 - c. Freestanding booth in a parking lot or shopping mall.
 - d. Metal pipe in which electrical wiring is installed.
- 6. The higher the R rating is:**
 - a. The greater the efficiency of the hot water heater.
 - b. The greater the resistance to the passage of heat (better heating insulator).
 - c. The less the efficiency of a furnace.
 - d. None of the above.
- 7. Soil pipe is used in:**
 - a. Irrigation.
 - b. Sewer system.
 - c. Agriculture.
 - d. Horticulture.
- 8. Each row of townships running north and south parallel to a true meridian is called a:**
 - a. Township.
 - b. Section.
 - c. Range.
 - d. Tier.
- 9. California has how many principal base and meridian lines?**
 - a. Only one.
 - b. Two.
 - c. Three.
 - d. Five.
- 10. In the planning and engineering of a tract for subdivision purposes, a “cul de sac” is frequently employed. This term is used in reference to the installation of:**
 - a. Sewage disposal.
 - b. Drainage.
 - c. Streets.
 - d. Recreation areas.



“Look at market fluctuations
as your friend rather than your
enemy; profit from folly rather
than participate in it.”

— Warren Buffett

CHAPTER 8: *public control & subdivisions*

Learning Objectives

The impact of government control of real estate is discussed in this chapter. Terminology specific to governmental control is also reviewed. Since the laws enacted by our government are the basis of property rights in the U.S., it is important to know how these laws are made and enforced on the national, state and local level.

key terms

Accretion	Downzoning	Police Power
Alluvium	Eminent Domain	Public Utility
Appropriation of Water	Final Public Report	Riparian Rights
Avulsion	Industrialization	Stock Cooperatives
Blanket Encumbrance	Irrigation District	Subdivision Map Act
Blighting Area	Land Projects	Taxation
Community Apartment Project	Mesne High Tide	Territorial Settlement
Community Redevelopment Act	Migration	Urban Renewal
Condominium	Mutual Water Company	Urbanization
	Planned Development	Variance

Effects of Federal, State, and Local Authority on Real Property and Real Estate Transactions

All property owned by a person is subject to sovereign power. Under certain constitutional restrictions, the state (either the United States or an individual state) may control property through the exercise of its sovereign power.

Three great rights of sovereignty are retained by all governments:

1. **Eminent domain** is the right by which the federal government, the state, or any agency of the state may take private property belonging to any individual, providing the property taken is intended for public use and the owner is compensated.
2. **Police power** is the right by which the state may destroy, impair the value of, limit the use of, or otherwise invade property rights to protect the public health, public morals, public safety, or the general welfare. The owner receives no compensation.
3. **Taxation** is the right by which government authority levies a charge against property for the purpose of securing money to defray the costs of government.

Eminent Domain

All property, whether it be real, personal, or mixed, is subject to the exercise of power of **eminent domain** and may be taken at any time by the state, providing the property taken is intended for public use. The only requirements are that the taking is necessary, the taking is for the public good, and the state or the public agency taking the property pays the individual property owner the fair market value of the property taken.

This requirement for reimbursement extends to anyone having a financial interest in the property, whether they are the titleholder or otherwise.

As examples of public use, the state legislature has declared that the power of eminent domain may be exercised to acquire property for:

- Streets
- Irrigation
- Railroads
- Electric power
- Public housing
- Off street parking
- Airports
- Sewers
- Schools
- Freeways
- Public buildings & grounds.

The federal government, states, cities, counties, improvement districts, public utilities, public education institutions, and similar public and semi public bodies may all exercise the power of eminent domain. Private persons may not use such power, except under unusual circumstances.

Procedure

Formal condemnation action by the agency taking the title is usually preceded by negotiations with the property owner. If the negotiations are successful, the agency and the owner enter into a purchase contract. If they are not successful, the taking of the title is accomplished by a court action called condemnation. The court must find affirmatively that the property is taken for a public use and that the taking is necessary. The court must also determine the just compensation to be paid to the property owner. Just compensation today is determined by appraising the property to determine its fair market value. In arriving at market value, the cost approach is rarely acceptable, except where the property is so individualistic that it is rarely traded on the market. Parties may agree to arbitration proceedings. The government even has the power to acquire riparian (water) rights by condemnation.

Depending upon the circumstances involved, either the title to the property is taken or an easement is acquired by the condemning agency. Title is taken where possession of the property is taken. An easement is created only when a specific use is acquired.

Sometimes public works are undertaken and damage to property results without condemnation action being filed by the public body. In such cases, the property owner may sometimes initiate the suit in what is known as an inverse condemnation action. If inverse condemnation proceedings result in judgment or settlement in favor of the plaintiff, costs must be paid by the government agency.

Under California law, should the state or any municipal authority take the property, they may pay the appraised property value in court and take possession upon the filing of their condemnation proceedings. A private corporation or individual taking by condemnation cannot take possession until the decree of the court has been entered and becomes final.

The government, during emergencies, may seize and make use of private property without prior notice, pending formal condemnation proceedings. This is practiced extensively during wartime.

Damages

Personal: Property owners may suffer damages by the taking of their property. Some of these must be compensated for and others need not be. Things for which no compensation will be considered include damages to business in the form of loss of profits, personal inconveniences, rerouting of traffic, value of options, and value of equitable servitudes. The exception is under the California Legislature Highway Relocation Act of 1971 when compensation will be paid for moving, cost of acquiring like property, and loss of personal property where a person is displaced from a dwelling, farm, or business.

Physical: The law will, however, recognize as damages the cutting off or serious impairment to means of access to a property to the extent that the property's market value is damaged. The law will also recognize severance damages resulting from full condemnation or partial condemnation—for instance, the taking of a portion of a parcel, leaving the remaining portion in such size or form as to make it less suitable for purposes for which the whole parcel could be utilized, thus impairing its use and causing loss in value. Damages caused by a survey must be compensated, whether property is taken or not.

Urban Renewal and Development

Urban renewal: A federal program known as Urban Renewal was initiated under the National Housing Act of 1954. It is primarily educational in nature, striving to awaken communities to the necessity of conserving or rehabilitating rundown areas before they become blighted.

Blighting: The visible and physical decline of a property, neighborhood, or city caused by a combination of economic downturns, residents and businesses leaving the area, neglect of property, and sometimes by the high cost of maintaining the quality of older structures. Any one of these factors may result in dangerous or undesirable living conditions for the tenants and/or property owners. Any property that has undergone blighting is said to be blighted.

Community Redevelopment Act: This is a state program under which the actual work of redeveloping or rehabilitating an area is undertaken in cooperation with the local commission or agency empowered by the community to plan for redevelopment. Communities that follow proper procedure under the Community Redevelopment Act may secure federal funds to purchase blighted properties. The substandard structures may then be demolished and the land resold to private investors for the erection of modern buildings or homes.

If a deed cannot be secured voluntarily, condemnation proceedings are employed to acquire title to the property. While there have been many protestations that this is an abuse of the power of eminent domain claiming that the property taken is not for “public use,” the courts have decided that this practice is constitutional because this program results in greater public benefit.

State Urban Renewal Laws: These laws protect property owners in urban areas and allow owners to participate in the redevelopment. The laws also provide a method for the relocation of persons compelled to move from the area to make way for the redevelopment. The state legislature enacted a State Urban Renewal Act to detail a program to provide rules and regulations by which their objectives can be achieved under the present Redevelopment Act.

Police Power

Police power is the right to regulate the use of privately owned property for the health, safety, morals, welfare, convenience, and necessity of the public. Under these regulations, the federal, state, or local government does not take title to the property as they do under eminent domain, and no compensation need be paid to the property owner. The power to tax is not a police power nor is police power ever used for the good of one person.

A distinction must be made between police power regulations and deed restrictions since they operate separately and apart, even though they may cover many of the same uses of property. Both are limitations on the use of property, but only one is imposed by governmental regulation; the other is created by agreements, deeds, or any form of written instrument executed by the owners of the land affected at the time they transfer the title to the property.

If one stops to reflect for a moment, it will be found that almost everything one does is controlled in some way, either directly or indirectly, by some police power regulation, from the control of motor vehicles to the regulation of business activities to the use of real property.

In addition to the laws dealing with police power that are passed from time to time, the state has police power in an emergency to do any of the things it might do by legislative enactment in order to care for the emergency situation. Thus, in San Francisco during the fire of 1906, the authorities assumed they had the right to dynamite buildings in an effort to prevent the spread of fire to other areas. Later, the courts agreed that such action was appropriate.

However, the power of government to regulate is not unlimited. Since we live under a constitutional form of government, the power of that government is limited by the Constitution. In reference to police power regulations, there are three limitations. The action:

1. Must be uniform in application
2. Must be nondiscriminatory
3. Must be for the public welfare.

Many of these regulations control the use of property, such as zoning or the sale of certain types of property, e.g., an establishment serving alcoholic beverages.

Planning and Zoning

The State Conservation and Planning Law requires that each county and city have a planning commission or area planning commission. The planning commission has responsibilities in the areas of zoning, approval of subdivisions, and generally for the physical development of the community.

The planning commission, in carrying out these responsibilities, devises a general plan or master plan. All elements and parts of a general plan must make up an internally consistent and compatible statement of policies for the city and/or county. This general plan provides guidelines for the future growth and development of the community in order for proper provisions to be made for the promotion of safety and public welfare. This is done through flood control, parks and recreation, streets and highways, sewage disposal, drainage, subdivision design, open space areas, and the setting aside of areas for residential, commercial, and manufacturing use, etc.

Zoning

The local governing body (City Council or County Board of Supervisors) has the power to pass ordinances establishing zones within which improvements must conform to certain use limitations and are allowed only restricted location on the lot. The right to zone comes under the rights defined under the police power of the government for the preservation of protection of public health, safety, morals, or general welfare.

Zoning may be divided into three areas of control:

1. **Land Use:** Land use is usually divided into residential, agricultural, commercial, and industrial, although there are many other specialized zones, such as parking.
2. **Structures:** In each specific zone, structures are limited as to height, bulk, size, and number of stories. For example: In a residential R 1 Zone, only single-family residences are allowed.
3. **Lot Areas:** Lot areas are controlled by specifying minimum lot size, as well as the portions reserved for structures through setback and sideline requirements.

Rezoning and Variances

Zoning may be changed at any time by amending the existing ordinances. Frequently, the planning commission will, on its own motion, initiate such a change when it is determined that it would best serve the community or when a change is indicated to carry out the general plan. Should a property in a rezoned area be substantially different from the use for which the new zoning is created, it is allowed to remain and is referred to as a non conforming use. Such a property is said to be “grandfathered” into the variance, and, as long as the property is maintained, the nature of the use of the property will pass to the heirs of the owner. The only exception to this rule is when the zoning change is applied retroactively. Courts have held that non conforming uses cannot be summarily eliminated by a retroactive ordinance unless the uses were such as to amount to a nuisance.

A zoning law cannot relieve land from lawful restrictions affecting the use of the land imposed by a prior recorded deed or by a prior recorded declaration of covenants, conditions, and restrictions. In this question, the deed restrictions will prevail.

If the planning commission decides to rezone an area from commercial to residential use, this kind of a change is usually identified as **downzoning**.

A zoning change may be initiated by the property owner on one or several parcels. The owner files a Petition for Rezoning with the local planning commission. This petition is normally referred to the planning commission that will hold public hearings after public notice and will refer the case to its technical staff for investigation and recommendation. If a vast majority of other property owners are already using their properties in a non-conforming way, it is much easier for a new owner to obtain a variance on the acquired parcel. An adverse decision by a planning commission can be appealed to the local City Council or Board of Supervisors.

A **variance** is more easily obtained where only one lot is involved. To obtain a variance, a Petition for Exception to Use is filed with the Board of Zoning Adjustment or the Zoning Administrator. If the city or county does not have a Board of Adjustment or a Zoning Administrator, the petition would be filed with the planning commission. The applicant attempts to show at a hearing called for the purpose that exceptional circumstances are applicable to his/her property and that the variance asked for will not be detrimental to the public and will not exceed the zoned use of the property. An adverse decision by a planning commission can be appealed to the local City Council or Board of Supervisors.

As a general rule, variances are not issued for uses that would be contrary to the applicable zoning ordinances but rather for considerations regarding parcel size and structure type.

Variances may affect the actual use of the property or may involve the size of the lot or the required setback lines. If the petition for a variance is turned down, the petitioner may appeal to the Board of Zoning Appeals, or, if a Board of Zoning Appeals has not been established, the applicant may appeal to the local legislative body that may reject or grant the variance.

Variances are sometimes granted with a condition for approval of plans and initiation of construction before a certain time. In other cases, the use variance is limited to a fixed time.

A variance will not be granted for a parcel of property that authorizes a use or activity that is not otherwise expressly authorized by the zone regulation governing the parcel of property.

Housing and Construction

Four laws directly or indirectly affect the way improvements upon real property may be constructed. The following laws control the construction of improvements:

1. The State Housing Law
2. Local building codes
3. The Health and Safety Code
4. The State Contractors License Law.

State Housing Law

The State Housing Law is designed to provide minimum construction and occupancy requirements for all dwellings throughout the state, including apartment buildings and hotels. Construction regulations under this statewide act are handled by local building inspectors under the local planning commission.

Local Building Codes

In 1970, the legislature amended the State Housing Law to make uniform or national codes applicable in lieu of local building codes. The law now provides that the regulations of the Commission of Housing and Community Development under the State Housing Law shall impose substantially the same requirements as the most recent editions of these codes. Local government retains only the power to determine local use zone requirements, local fire zones, building setback, side and rear yard requirements, and property line requirements. Local variances are permitted when evidence exists that compliance with the uniform codes would be unsafe. If there is a conflict between this law and the State Housing Act, the most restrictive (highest degree of safety) would be enforced.

In the matter of factory-built housing, local government can undertake the function of in plant inspections within their jurisdictions in accordance with the standards set by the commission. The local authorities supervise the installation of factory-built housing on the site.

Construction regulations are handled by local building inspectors. Regulations concerning occupancy and sanitation are enforced by local health officers.

The procedure for new construction or building alterations requires an initial application to the local building department for a building permit. The application must be accompanied by plans, specifications, and plot plan. When the application has been examined, revised where necessary, and approved, a building permit is issued after payment of necessary fees. No construction or alteration can be commenced prior to issuance of a building permit. When construction has been completed, final inspection made, and construction has been approved, a Certificate of Occupancy is issued to the owner. Local ordinances may require use, occupancy, and zoning reports from the city prior to transfer of title.

Because of these requirements, there is a presumption that all improvements on real property were constructed according to the building code at the time they were erected and a permit issued. If no permit was obtained and the structures do not conform to the building code, the local building department may order the improvements removed. A purchaser of improved real property has a right to rely on this presumption. If the improvements do not comply with the requirements, the purchaser would have a cause of action for damages against the person from whom he/she purchased the property or the person who erected the improvements illegally.

When there is any doubt as to whether the construction or alteration of an existing structure meets code specifications, the local building department will usually, for a fee, make an occupancy survey and report on the condition of the structure. If a construction permit was issued and the item was installed in the building in conformance with that permit, it would not be classified as substandard if today it is fully functional and not a danger.

Health and Safety Code

The State Department of Health Services may control and regulate the statewide enforcement of health measures. As a rule, however, the local health officer (required to be appointed in every county and city) enforces both state and local health laws and uses the State Department of Health Services for advice.

Drainage, plumbing, sewage disposal and water supply are all under the jurisdiction of both the local health officer and the State Department of Health Services. They may require the halting of any proposed development that might result in contamination of the water supply or drainage system, or that might result in improper sewage disposal. Furthermore, the sanitary conditions of all housing are subject to control by the health authorities.

Acts of discrimination in housing accommodations because of race, color, religion, sex, marital status, national origin, or ancestry have been under the jurisdiction of the Department of Fair Employment and Housing. This legislation is now a part of the Government Code of California Laws.

This code is deemed to be an exercise of the police power of the state for the protection of the welfare, health, and peace of the people of California.

State Contractors License Law

This law contains an entirely different approach to construction regulation. The purpose is to protect the public against incompetent building contractors and subcontractors. This is achieved by requiring construction to be done by licensed persons and includes subcontract work as well as general and engineering work.

The construction profession is divided into three major categories:

1. General Engineering
2. General Building
3. Specialty Contracting.

Separate qualifying examinations are given for each category. In addition to passing the examination, the applicant is required to have had a specified length of time in experience in the line of work. The examination includes legal matters affecting the construction industry and estimating construction work.

The only construction work that can be done without a license is construction for one's own occupancy, without intent to sell.

Subdivisions

Subdividers, developers and builders have realized large sums in profits by subdividing large land holdings into smaller tracts, which buyers prefer. Basically, there are four factors that make subdividing both profitable and of necessity. The four are:

1. **Industrialization** - which happens as a civilization moves from an agrarian economy to an industrial economy.
2. **Urbanization** - which means the tendency to settle large numbers of people into close-knit cities.
3. **Migration** - the tendency of people to lift their roots and readily travel anywhere with little restraint.
4. **Territorial settlement** - created when a government encourages people to populate frontier areas, increasing the demand for land.

When selecting land for development, the developer often chooses suburban rather than urban land. The principal reason for this choice is that in an urban area, the development has been completed. The land costs are higher. The zoning and utilization of the land has been fairly well defined. Flexibility of uses is limited. In a suburban area, development costs are lower and developers have the freedom to select the type of development based on their interests; developers are not confined into a "strait jacket" of preconceived city plans. A developer may plan self-contained communities, complete with shopping centers and recreational, school, and church facilities.

The most vital factor in planning a subdivision in which lots are to be sold for a profit is a market analysis. Once a subdivider has made an analysis of the area in which he/she or she intends to build, there are stringent laws that must be obeyed.

Two laws in California control the development and sale of subdivisions:

1. The Subdivided Lands Act is found in the Business and Professions Code.
2. The Subdivision Map Act is found in the Government Code.

According to the Subdivided Lands Act, a subdivision is generally defined as the division of any improved or unimproved land into five or more parcels for sale, lease, or financing, whether immediate or future, and includes such division as a condominium or community apartment project. The land to be divided may be single parcel, or contiguous or separate parcels. The law administered by the Real Estate Commissioner Subdivided Lands Act also includes a minimum of five parcels along with a Planned Development and a Stock Cooperative as forms of a subdivision.

Subdivision Map Act

This law establishes that the regulation and control of the design and improvement of subdivisions are vested in the legislative bodies of local agencies. Each local agency, by ordinance, regulates and controls the physical aspects of subdivisions for which this law requires a tentative and final or parcel map.

Under the provisions of the **Subdivision Map Act**, the local authorities (planning commission) have approval over the general layout, zoning, streets, lot size, and the improvements required in that area. This includes the way of road surfacing, sidewalks, drainage, sewage disposal, public utilities, and the dedication of land for recreational and educational facilities. The subdivider is responsible for the improvement of the dedicated areas. Dedication may also be required of access routes to public resources such as beaches, rivers, lakes, etc. It will also include easements necessary for the inclusion and maintenance of sewers, lines, and cables serving properties in the subdivision. The planning commission makes recommendations to the City Council or Board of Supervisors.

If an easement over a particular property is taken by dedication, the original subdivide may obtain a release from the government if the public authority discontinues the use of the easement for the purpose it was granted.

The basic procedure for processing a subdivision of five or more lots, as set forth in the Subdivision Map Act, is as follows:

- Prepare a tentative map and file it with the city or county.
- Prepare a final map incorporating all changes required by the city or county.
- Obtain certificates from all persons having recorded interests in the property consenting to recordation of the final map and offering public areas for dedication.
- The subdivider must then enter into an agreement with the city or county for the improvement of streets and easements, supported by a performance bond.
- After a Certificate of Acceptance has been accepted, the final map is recorded.

The Map Act exempts subdivisions of five or more parcels from the required tentative and final maps in the following circumstances:

1. The land, before division, must contain less than five acres, and each parcel must abut upon a maintained public street or highway with no dedications or improvements required.
2. Any parcel divided into lots or parcels, each of an area of 20 acres or more, and each has an approved access to a maintained public street or highway.
3. Each parcel created by the division has a gross area of 40 acres or more, or each of which is a quarter section or larger or such other amount up to 60 acres, as may be specified by local ordinance.

4. The land consists of a parcel or parcels of land having approved access to a public street or highway that comprises part of a tract of land zoned for industrial or commercial development and that has the approval of the governing body as to street alignments and widths.

In the case of any of these exceptions, it is necessary that a Parcel Map be filed with the county. It should be emphasized that these exceptions do not apply to the subdivision sections of the Real Estate Law.

Local ordinances may determine, to a certain degree, the procedures to be followed if the state law does not cover them.

Subdivided Lands Act

Whereas the basic purpose of the Map Act is to give local authorities control over the physical development of subdivided property, the purpose of this law, which is administered by the Real Estate Commissioner, is to protect the public against fraud, misrepresentation, and deceit in the sale of subdivided property. To comply with this law, the subdivider must obtain the Final Public Report from the Department of Real Estate prior to the sale, lease, or financing of any parcels, whether located within California or outside of the state.

The normal method of obtaining this **Final Public Report** is for the owner, the owner's agent, or the subdivider of the proposed development to file with the Department of Real Estate an application for a public report. This consists of a Notice of Intention and a completed questionnaire on a form prepared by the Department of Real Estate, along with an appropriate fee. The Notice of Intention to subdivide will contain the following information:

- ▢ The name and address of the owner(s).
- ▢ The name and address of the subdivider.
- ▢ The legal description and area of lands.
- ▢ A true statement of the condition of the title to the land, particularly including all of the encumbrances applicable.
- ▢ A true statement of the terms and conditions on which it is intended to dispose of the land, along with copies of any contracts intended to be used.
- ▢ A true statement of the provisions, if any, that have been made for public utilities in the proposed subdivision, including water, electric, gas, sewer, and telephone facilities.
- ▢ A true statement of the use or uses for which the proposed subdivision will be offered.
- ▢ A true statement of the provisions, if any, limiting the use or occupancy of the parcel in the subdivision.
- ▢ Such other information as the owner, owner's agent, or subdivider may desire to present.

The Commissioner will then request additional information to investigate and report any findings. The subdivider must give proof of having complied with all of the requirements of the local governing bodies as they carry out the provisions of the Subdivision Map Act.

A person acting as a principal or agent who intends, in this state, to sell, lease, or offer for sale or lease lots, parcels, or interests in a subdivision situated outside of this state but within the United States, shall, prior to a sale, lease, or offer, register the subdivision with the Commissioner. An application for registration shall be made on a form acceptable to the Commissioner and include, along with a fee, a description of the offering, certification by the applicant that the subdivision is in compliance with all applicable requirements of the state or states wherein the project is located, evidence of this compliance, if applicable, and a consent to service.

The Commissioner, within 10 days of receipt of an application of registration, shall provide the applicant with notice of the completion of the registration or a notice of deficiency. If the department does not provide a notice within 10 days, the registration shall be deemed complete.

The Department of Real Estate investigates a subdivision to make sure that all information submitted by the subdivider is correct. When the investigation is complete, the Commissioner issues a Public Report and then the sale may proceed. In effect, this Public Report is a “permit,” since no subdivider legally may offer any lots for sale until the report has been obtained. The Commissioner has two alternatives:

1. To issue the Public Report following the investigation.
2. To call a hearing to determine whether the sale should be stopped.

If the Commissioner’s investigation indicates that the sale would work a fraud upon the public, the Commissioner is required to hold a hearing.

Similarly, if, after the Final Report has been issued, the owner or subdivider violates any of the regulations, or if it appears to the Commissioner that further sale or lease of the subdivided lots would constitute grounds for denial of the Final Report in the first place, the Commissioner may order the person to desist and refrain from such violations or from further sale or lease of lots. In this case, the subdivider may request a hearing on the order.

It is important to note that the developer or subdivider is responsible for delivering a copy of the Final Report to the buyer, giving the buyer a chance to read it and become acquainted with the information the Commissioner has secured before the buyer commits to the purchase. In addition, the subdivider must obtain a signed receipt for the copy and keep the receipts on file for the Commissioner’s inspection for at least 3 years. Failure to do this may be a basis for stopping the sale of the subdivision and revoking the licenses of any sales agents involved. A Final Report is valid for five years unless renewed. Renewal becomes necessary if the subdivider rents the units and the five-year term expires. When the subdivider decides to sell, an amended report will be necessary.

If the public report is used for advertising, the whole report must be used. The report cannot be highlighted or used in part. It must be reproduced exactly as approved by the Commissioner.

A copy of the public report must now be given by the owner, subdivider, or agent at any time, upon oral or written request, to any member of the public. In addition, a copy of the public report and a statement advising that a copy of the report may be obtained from the owner, subdivider, or agent as stated shall be posted in a conspicuous place at any office where sales, leases, or offers to sell or lease lots within the subdivision are regularly made. The Real Estate Commissioner's office maintains a file of all subdivision Final Public Reports. This information is available to the public.

Ordinarily, the sale of subdivision lots is prohibited by the Commissioner until the subdivider has made a complete filing and a Final Public Report is issued. However, the Commissioner may, in some instances, issue a "Preliminary Public Report" which permits the subdivider to take a deposit in connection with advance lot reservations before the filing is completed, due to some unusual circumstances. The taking of a deposit does nothing but create a reservation—it is not a sale. It must also state the unilateral right of either the subdivider or the potential buyer to cancel the reservation at any time. The Preliminary Report is valid for one year or until the Final Report is issued, whichever occurs first. The Preliminary Report is frequently referred to as the "pink" report because it is published using pink paper stock.

A copy of the Preliminary Report must be given to the buyer and a receipt taken. The deposit may not be used by the subdivider but must be placed in a neutral depository, along with the receipt, and returned to the buyer on demand, should the buyer cancel the reservation.

The law requires county assessors to separately assess the interests of shareholders in stock cooperatives and co tenants in community apartment projects upon written request of the owner of such interest.

False or misleading advertisements, broadcasts, or telecasts concerning subdivisions is prohibited. For a violation of this provision or any other provision in the law, any person shall be deemed guilty of a public offense punishable by a fine not exceeding \$10,000, or by imprisonment in the state prison or county jail not exceeding one year, or by both.

The Subdivided Lands Act presently exempts all owners, subdividers, and their agents from the necessity of filing a Notice of Intention to subdivide and from obtaining a Final Public Report when the proposed subdivision meets all of the following requirements:

- The owner, subdivider or agent has complied with all legal requirements established to safeguard the interests of the buyers of such lots, subject to a blanket encumbrance, to be certain that these buyers actually acquire what they intend to purchase;
- The subdivision is not in any form of common ownership subdivision, as identified in the law;
- Each lot, parcel or unit of the subdivision is located entirely within the boundaries of the city; and

- Each lot, parcel or unit of the subdivision will be sold or offered for sale improved with a completed residential structure, with all other improvements that are necessary to occupancy completed or with financial arrangements determined to be adequate by the city to insure completion of such improvements.

Material Changes

Material changes in the subdivision, its handling after the filing is made, or the Final Public Report is issued must be reported. This not only includes physical changes such as changing the lot or street lines, but any new condition or development that may affect the utility value of a subdivision or the terms of the offering.

Changes in contracts, deeds, etc., used in the sale of lots or units in a subdivision may constitute a material change to be reported to the Commissioner. The purpose of reporting is to enable the Commissioner to revise the public report and to set forth the true conditions existing in the subdivision after any material change has occurred, or to take other action, as warranted.

Changes in any documents that would materially change the rights of any purchaser or of restrictions on any parcels or units in a planned development, community apartment, condominium, or stock cooperative project require prior written consent of the Commissioner to be effective or legally binding.

The owner or developer of any type of real estate subdivision must report to the Commissioner the sale or lease of five or more parcels or units to another person. The contract to option five or more units to a single person must also be reported. The new parties (owners in these instances) are potential subdividers and must obtain their own appropriate Public Reports.

Failure to report a material change not only violates the law but may also furnish a basis for rescission of purchases through court action.

If the subdivider uses the Public Report for advertising purposes, it must be reproduced exactly as approved by the Commissioner.

Desist and Refrain Orders

Should the Commissioner find that any owner, subdivider, or other person is violating any of the provisions of the Subdivided Lands Act, the Commissioner may affect the immediate cessation of such violations or the immediate termination of selling or leasing of the property by the issuance of an order to Desist and Refrain from such activity.

Blanket Encumbrance

A **blanket encumbrance** is one that is secured by more than one parcel of property. This type of financing is often used in connection with construction loans to builders. One blanket mortgage (trust deed) initially covers the entire tract. As individual houses are sold to various buyers, a partial release (release clause) is usually obtained from the blanket loan. In California, the document commonly used is a partial reconveyance deed. The buyer receives a grant deed, a separate loan is made to the new buyer, and either all or a portion of the proceeds of this new loan are paid by the seller against the blanket loan to obtain the release of the sold property. Until the release is actually recorded, the subdivider must maintain the buyer's money in a trust account.

Where there is no blanket encumbrance involved, the subdivider must protect the buyer's deposit by one of the following:

- Place all of the buyer's money into a neutral escrow or trust account until title or other interest is delivered, default is made by either party, or the money is returned to the buyer.
- A bond is furnished to the state until title is delivered to the purchaser.
- An approved association of which the seller is a member furnishes a bond for protection of the buyer.
- Seller furnishes lien and completion bonds on improved residential land.
- All moneys paid go into a neutral escrow and are paid out only for payments on construction of improvements on the land.

Exceptions

While the law designates a subdivision as the dividing of property into five or more parcels with the intention of selling, leasing, or financing, now or at any time in the future, it does not include divisions into parcels of not less than 160 acres that are designated by lot or parcel description by government survey, unless such division is for the purpose of sale for oil and gas purposes; nor does it apply to the leasing of apartments, stores, or similar space within an apartment building, industrial building, or commercial building. Subdivisions limited to an area expressly zoned for industrial or commercial use are exempted from the requirement of obtaining a public report.

Common Ownership Subdivisions

In today's circumstances, where improved or unimproved lots are developed to be owned in common by many persons under some form of cooperative ownership, such development would be a subdivision under California statutes and would be subject to all applicable California subdivision laws.

There are five recognized types of common ownership developments under California law:

1. Planned development
2. Community Apartment Project
3. Stock Cooperative
4. Condominium
5. Timeshare.

Upon written request of the owner of a lot or unit in a common ownership subdivision, the governing body of such subdivision must provide that owner a copy of the declaration of restrictions, bylaws, and articles of the corporation, applicable at the time of the request. The owner must do this within 10 days of the delivery of such request. The governing body may impose a fee for providing such documents, but the fee cannot exceed the reasonable cost of preparing such documents.

Planned Development: Consists of separately owned lots where one or more additional lots are owned in common, or there are mutual, common, or reciprocal interests in the separately owned lots. The development must consist of five or more lots to be a subdivision and may involve title or leasehold interests. Since the planned development does not necessarily involve improved land, it could also be a land project.

Community Apartment Project: A community apartment project is defined as the ownership of an undivided interest in the land when coupled with the right of exclusive occupancy of any apartment thereon. To be classified as a subdivision, the community apartment project must be made up of five or more units. The units are financed as one and the title insurance is issued on the entire project.

Stock Cooperatives: A stock cooperative is created when a corporation is formed for holding title, in fee or as an estate for years, to improved real property where the shareholders receive a right of exclusive occupancy to a portion of the real property. This right of occupancy is transferable only concurrently with the transfer of the shares of stock in the corporation. The corporation must intend to have five or more shareholders to be considered a subdivision.

Condominium: A condominium is an estate in real property that consists of an undivided interest in common in a portion of real property, coupled with a separate interest in space called a unit, the boundaries of which are described on a recorded final map, parcel map, or condominium plan in sufficient detail to locate all of its boundaries. The area within these boundaries may be filled with air, earth, or water, or any combination thereof, and need not be physically attached to land, except by easements for access and, if necessary, support.

“No amendments or alterations in declarations of restrictions, which would materially change the rights or restrictions of any interest in a condominium, can be accomplished without written consent of the Real Estate Commissioner.” This requirement does not have to be met after one year from the time the subdivider ceases to hold or directly control 1/3 of the votes that may be cast in a meeting concerning such a change.

The legal interest or estate may be a fee simple ownership, estate for life, or an estate for years (lease), and may be held in severalty, in joint tenancy, in tenancy in common, or as community property. A condominium must be made up of five or more units to be treated as a subdivision.

In the treatment of condominiums, project means the entire parcel of property, including the structures; unit means the air space, earth, water, and other elements that are not owned in common; and common areas means the entire project, except the units.

When the project is created, the Subdivision Map Act applies to the physical development, as well as to the legal requirements for management, restrictions, etc. The Map Act requires the recording of the plan, including a survey map, a floor plan of each building, identification of each unit, a certificate of Consent to Record, and a provision to remain a condominium until a revocation is recorded.

The original owner developer of a condominium project must record a Declaration of Restrictions that binds all owners of units in the project and is enforceable by any unit owner. The restrictions may provide for the management of the project by the owners, an elected agent, or a Board of Governors; amendment of restrictions by majority vote; independent audit of accounts; reasonable assessments for authorized expenditures; and subordination of liens securing such assessments. The duties of a condominium project management group may include clerical work covering contract rights, accounts payable, and accounts receivable for the benefit of the condominium owners.

Unpaid assessments by the management body become a lien against the unit when “notice” of it is recorded. Even if the unit is homesteaded, the lien may be foreclosed upon.

When a unit owner orders work, a mechanic’s lien applies to the owner’s individual interest in the common areas and to the owner’s unit only. When management orders work, a mechanic’s lien may be filed on the entire project. The unit owner may remove a project lien from the owner’s interest by paying the owner’s proportionate share of such lien.

The unit (separate ownership) boundaries are the interior surfaces of the perimeter walls, floors, ceilings, windows, and doors thereof, together with the intruding outlets (fixtures) of pipes, ducts, and conduits from the walls, ceilings, and floors. All other areas, equipment, utility installations, structures bearing walls, and the land are the common areas in which each unit owner has a tenancy in common interest in equal shares with the other unit owners.

In effect, this provides that a purchaser of a condominium owns the air space in which the owner’s particular unit is situated in fee simple, has a deed, gets separate tax assessment, and the owner may apply for and acquire a title insurance policy on the property. In addition, the owner has an undivided interest in common in certain other defined sectors of the whole property involved.

The owners and developers of lots or units in subdivisions that have commonly owned facilities (condominiums, planned developments, stock cooperatives) are required to give prospective purchasers copies of the CC&R's articles of incorporation and bylaws as soon as practical, before the transfer of title or the completion of a real property sales contract.

A buyer of a condominium other than the original buyer from the subdivider must be given a copy of the articles and bylaws of the association, the most current financial statement, and the deed restrictions.

If, in any of these four types of cooperative co-ownerships, there are any accompanying memberships, rights, leases, articles, bylaws, contracts, deed restrictions, or interests in a Home Owners Association (HOA), these items are subject to the law and the regulations of the Commissioner. A copy must be given to any purchaser other than the original purchaser from the subdivider.

Timeshare Subdivisions

A timeshare project is identified as a subdivision when the development consists of 12 or more timeshare estates, timeshare uses having terms of five years or more, or having terms of less than five years that also include options to renew. Timeshare uses, whether or not assignable and that are created in real property other than structural dwelling places, will not be treated as subdivisions.

Some related terms are:

- ▢ A timeshare project is one in which a purchaser receives the right for a period of time that has been or will be allotted from the use or occupancy periods into which the project has been divided.
- ▢ A timeshare estate is a right of occupancy in a timeshare project that is coupled with an estate in the real property.
- ▢ A timeshare use is a license, contractual, or membership right of occupancy in a timeshare project which is not coupled with an estate in real property.
- ▢ Any purchaser of either a timeshare estate or a timeshare use in a timeshare project may rescind their contract to purchase until midnight of the third calendar day following the day they signed the contract to purchase. These purchasers must be notified in advance by the subdivider of these rescission rights.

Federal Subdivisions

Regulations of federal subdivisions fall under the federal Interstate Land Sales Full Disclosure Act. Under federal law, a subdivision is defined as “any development divided into 25 or more parcels or lots that are not improved with structures at the time of sale and are offered for sale by mail or in interstate commerce.” The regulatory agency established by Congress for land promotions that are offered in interstate commerce or by mail is the Department of Housing and Urban Development (HUD).

Unless specifically exempted, a developer may not sell or lease lots in a subdivision using the mail or some such other means of transportation, or in interstate commerce, unless a Statement of Record is in effect according to the provisions of this law. In all such transactions, the developer must give each purchaser a printed Property Report, as prescribed by this law, in advance of the purchaser signing a contract or agreement of sale.

This law does not apply to:

- The sale or lease of lots in a subdivision containing fewer than 25 lots.
- The sale or lease of improved land or the sale or lease of land under a contract that obligates the seller or lessor, within a period of two years, to erect a building thereon.
- The sale of lots in a subdivision if each lot in the subdivision contains at least 20 acres.

All purchasers have the option to revoke a contract or lease, with regard to a lot not otherwise exempt, until midnight of the seventh day following the signing of a contract or agreement. This is federal law. The California 14-day revocation period was eliminated in 1998.

Purchasers may revoke contracts and agreements (including promissory notes) within two years from the date of signing the contract or agreement if the required Property Report was not given to the purchaser before signing the contract or agreement to purchase. This fact must be clearly stated in all contracts and agreements to purchase.

If a contract or agreement (including a promissory note) is revoked as allowed by law, the purchaser shall be entitled to a return of money paid under the contract or agreement to purchase.

Any developer subject to this law, and who, in the judicial process, is convicted of willfully violating the provisions of this law, is punishable by a fine of not more than \$5,000 or by imprisonment of not more than five years, or both.

Land Projects

In 1969, state law introduced land projects into subdivision law in California. **Land projects** are defined as “development into 50 or more unimproved lots in a rural area with less than 1500 registered voters within the subdivision or within two miles of the subdivision.” The subdivision will not be subject to land project special regulations if all the lots are sold only to builders or developers. Special regulations also do not apply if they are not sold with substantial direct mail advertising with no more than 10% of the price allowed for overhead and advertising and no more than conventional commissions. A land project is similar to a planned development inasmuch as the lot owners have access to all areas in common.

No public report on a land project will be issued unless the Commissioner is satisfied that completion bonds or impounded cash is available to assure completion, maintenance, and financing of roads, utilities, community facilities promised, or other amenities in the offering. Bonds and impounds will not be required if all the improvements are completed and paid for, if no lien or assessment is imposed on any lot for any cost of construction, or if the developer guarantees the preservation of each offsite improvement from damages not insurable under title policies. Once a public report has been issued on a land project type subdivision in California, a copy of that report must be given to any member of the public upon oral or written request.

The 14-day recession period was rescinded in 1998.

Excerpts from the Subdivision Law

Subdivided lands and subdivision refer to improved land, lands divided, or proposed to be divided, for the purpose of sale, lease, or financing, whether immediate or future, into five or more lots or parcels. However, land or lands sold by lots or parcels of not less than 160 acres that are designated by such lot or parcel description by government surveys shall not be deemed to be a subdivision unless divided for the purpose of sale for oil and gas purposes.

This law does not apply to the leasing of apartments, offices, stores, or similar space within an apartment building, industrial building, commercial building, or mobilehome park, except that the offering of leases for a term in excess of five years to tenants within a mobilehome park as a mandatory requirement and prerequisite to tenancy within the mobilehome park shall be subject to the provisions of this law. The leasing of apartments in a community apartment project and the creation of a timeshare project in an apartment or similar space in a commercial building or complex shall be subject to this law.

For review, a land project is all of the following:

- ▣ A subdivision of 50 or more lots.
- ▣ Any 50 lots to be unimproved with buildings and offered for purposes other than industrial, commercial, institutional, or agricultural use.
- ▣ A subdivision in an area of less than 1500 registered voters within the subdivision or within two miles of the boundaries described in the Final Public Report.
- ▣ Not to include community apartment projects or stock cooperatives.

A subdivision is not a land project if any one of the following applies:

- ▣ All lots are offered for sale only to builders and developers.
- ▣ The lots are not to be sold by substantial direct mail advertising; sales promotion costs must be nominal, including conventional commissions; allowances of not more than 10% of the selling price are used for overhead and advertising.

Subdivided lands include:

- ▣ Any planned development of five or more lots.
- ▣ Any community apartment project of five or more apartments.
- ▣ Any condominium project of five or more units.
- ▣ Any stock cooperative with five or more shareholders.
- ▣ Any memberships or privileges in connection with the above.

Prior to the time when subdivided lands are to be offered for sale or lease, the owner, owner's agent, or subdivider shall notify the Commissioner in writing of the intention to sell or lease such offering.

Prior to the issuance of promissory notes secured by individual lots in an unrecorded subdivision, the owner, owner's agent, or subdivider shall notify the Commissioner in writing of the intention to issue such notes.

After receiving the Notice of Intention, the Commissioner may require such additional information concerning the project, as deemed necessary. This may include the preparation of a questionnaire for the owner, owner's agent, or subdivider to answer.

It is unlawful for the owner, owner's agent, or subdivider of the project, after it is submitted to the Department of Real Estate, to materially change the setup of such offering without first notifying the Department of Real Estate.

This law interprets a blanket encumbrance to be a trust deed or mortgage or any other lien or encumbrance, mechanic's lien or otherwise, securing or evidencing the payment of money and affecting land to be subdivided or affecting more than one lot or parcel.

Taxes and assessments levied by public authority shall not be considered a blanket encumbrance.

It is unlawful for the owner or subdivider to sell or lease lots or parcels within a subdivision that are subject to a blanket encumbrance unless there exists in such blanket encumbrance or other supplementary agreement a provision, referred to as a release clause. This is done to protect the purchasers against the creation of fraudulent conveyances. Real Estate Law states "taxes and assessments levied by a public authority shall not be considered a blanket encumbrance."

This section provides for certain conditions that must be met by the owner, agent, or subdivider where the blanket encumbrance does not contain a release clause. Under this section, the subdivider may, in lieu of having a release clause in the blanket encumbrance, put title in trust, post a bond, or meet other requirements for the protection of the purchaser's deposit and thus release the deposit for his/her use.

The Commissioner does not inspect out-of-state subdivisions.

When the Department of Real Estate makes an examination of any subdivision, the Commissioner shall make a public report of the findings.

A copy of the public report of the Commissioner, when issued, shall be given to any prospective purchaser by the owner, agent, or subdivider prior to the execution of a binding contract or agreement for the sale or lease of any lot or parcel in a subdivision. A copy shall be furnished to any member of the public upon request. This also applies to repossessed lots or parcels.

A flood hazard and drainage report may be required in the filing for a subdivision Final Public Report. If a hazard exists, the degree of hazard must be reported. The three degrees of flood hazard are inundation, sheet overflow, and ponding of local storm water.

No person shall sell or lease, or offer for sale or lease in this state, any lots or parcels in a subdivision without first obtaining a public report. This law does not apply to the proposed sale or lease of expressly zoned industrial subdivisions that are limited in use to industrial purposes and are expressly zoned commercial subdivisions, which are limited in use to commercial uses.

The Commissioner shall not issue a public report on any land project until the Commissioner finds reasonable arrangements to assure completion, maintenance, and financing of the total complex including roads, utilities, community facilities, or other amenities in the offering. This section shall not apply to land projects if all of the following are satisfied:

All of the improvements have been completed and paid for.

No lien or assessment is imposed on a lot for any cost of construction.

The developer has guaranteed the management, maintenance, operation, use, and preservation of each offsite improvement from damage by causes not insurable under the standard or extended coverage insurance until five years have elapsed.

Any amendments or alterations of any provisions in any deeds, conveyances, leases, declarations of restrictions, by-laws, management contracts, etc., shall not be made without the written consent of the Real Estate Commissioner.

Each subdivider of a land project shall submit reports on or before the 10th day of each calendar quarter. These reports must give the names and addresses of all persons who had agreed to buy and who withdrew or attempted to withdraw by notice, or failed to make payments for 90 days or more after due date, by a claim of rescission or otherwise.

The Commissioner may issue an order prohibiting the sale and/or lease of the property in this state if the examination of the project shows that the sale or lease would constitute misrepresentation.

It is unlawful for any owner, subdivider, agent, or employee of a subdivision to authorize, use, direct, or aid in the publication, distribution, or circularization of any advertisement, radio broadcast, or telecast concerning subdivided lands, which contains any statement, pictorial representation, or sketch which is false or misleading. No improvement, facility or utility service may be advertised unless it has been completed or installed and is available for use, or unless completion and availability for use are assured through bonding or other arrangements approved by the Commissioner. If not completed, the estimated date of completion shall be set forth in the advertising.

Any person who violates any of the provisions of this code shall be guilty of a public offense punishable by a fine not exceeding \$10,000, or by imprisonment in the state prison or county jail not exceeding one year, or both.

Every sales contract relating to the purchase of real property in a subdivision as defined in this chapter shall clearly set forth the legal description of the property, encumbrances outstanding at the date of the sales contract, and the terms of the contract.

The term subdivision means improved or unimproved land or lands divided or proposed to be divided for sale or lease, whether immediate or future, into five or more lots or parcels. The term includes the conversion of existing improved property such as an apartment house into condominiums. Under this special circumstance wherein the property to be subdivided is already occupied, the subdivider must give the existing tenants a minimum of 180 days' notice of the start of the conversion. First right of refusal to purchase their existing apartment is also given.

If a land developer offers a free prize to anyone who replies to the developer's direct mail advertisement and visits the site of the developer's subdivision where the subdivider requires the prize winner to attend a sales presentation at the subdivision site prior to awarding them the prize, the sales presentation is legal, provided that the ad states the conditions to receive the prize. Failure to disclose that requirement makes it illegal.

Water Rights

In California, the landowners have no ownership of specific underground water nor absolute ownership of waters running across or bordering their property, such as a river or stream. In this state, the rights of an overlying landowner to use sub surface (percolating) waters are correlative to the rights of fellow overlying owners to reasonable and beneficial use of those waters. The owner of land that touches upon a natural watercourse enjoys certain benefits known as **riparian rights**, whereby the owner has the right along with other such landowners to use such waters in a "reasonable manner."

If a landowner holding riparian rights subdivides the property, those lots that do not abut the water will not convey the riparian rights previously held by the entire property.

Often, water in rivers changes its course. If the boundary of a property is a metes and bounds description and the river or waterway is one of the boundary lines, then the owners on each side of the watercourse could either lose or gain property.

Additional Related Terms:

Alluvium: Deposits of earth made by the natural action of water.

Accretion: An addition to land from natural causes, such as from gradual action of the ocean or river waters.

Avulsion: A loss of land due to the tearing away of the banks next to a river or watercourse (also called erosion).

Tidelands are measured by the mesne (normal) high tide line. As the climate warms and the waters in the oceans increase, the **mesne high tide** line will go further inland. This is another example of avulsion.

Because of the semi arid climate, conservation of water resources is important in California, and a vast body of detailed water laws has been enacted. Much litigation arises in connection with water rights, and the courts are authorized to refer all such litigation to the State Division of Water Resources for investigation, hearing, and preliminary determination, subject to final court approval, thus making use of the specialized knowledge and personnel of this agency. Should a litigant or other individual appealing to the board be awarded the rights to the use of non-abutting water, the action is called Appropriation of Water. The person or entity receiving the appropriation gains the taking, impounding, or diversion of water flowing on the public domain from its natural course and the application of the water to some beneficial use, personal and exclusive to the appropriator (taker).

Mutual Water Company - A non profit company organized by water users in a given district to develop and furnish water to its stockholders at reasonable rates. Articles of incorporation are filed with the Secretary of State, Division of Corporations. Usually, each share is made appurtenant to a parcel of land and cannot be sold separately. This enables the company to plan its distribution more easily and prevents speculation. Water costs depend upon the expense involved. Assessments may be levied if more money is needed for development.

Public Utility: A corporation that is a private enterprise conducted for profit to its owners. Such corporations are under the supervision of the State Public Utilities Commission. They may give service only in the district allotted to them. The Commission issues a Certificate of Public Convenience and Necessity. Such privilege is called a franchise.

Irrigation District: A district created under a special law for developing and furnishing water, primarily for agricultural purposes. It has many characteristics of other local governments such as a municipal government. It is said to be a quasi public corporation, which means it is in the nature of a political subdivision. Bonds for development may be voted by residents of the district, subject to validation by a court.

The term water table denotes the distance from the surface of the ground to the depth to which groundwater has risen. **Potable** water refers to drinkable or purified water. Percolation is the act of water draining or passing through a porous substance such as the earth.

Flood Control

A landowner has certain basic rights to the disposition of floodwaters coming upon the owner's property. This basic right gives every property owner the right to have the owner's land drained in its natural state.

Ground waters are divided into three broad classifications for the purpose of legal analysis:

1. Waters flowing in a defined channel.
2. Waters overflowing a defined channel.
3. Water flowing across the surface of the earth that is not contained in a defined channel.

A defined channel is any natural watercourse, even though it may be dry during a good portion of the year.

Water flowing in a defined channel may not be obstructed or directed by the landowner. A wall, bank or mound across the flow of water constitutes a dam and is prohibited. Changing the direction or diverting the flow is also prohibited.

Water overflowing a defined channel is considered floodwater. Any landowner may take protective measures from floodwater by reasonable methods, such as building up the sides of the channel with a dike, even though this might result in the overflow of the channel where it runs across another's land.

Water flowing across the surface of the land may not be obstructed in such a manner as to flood the owner above, nor may such waters be diverted or concentrated upon the landowner below by artificial structures such as streets or ditches. This does not affect the landowner's right to dike the sides of a defined channel.

As in the case of the use of water, these rights to the disposition of floodwater are controlled by police power regulations. Thus, the grading ordinances of most communities require that property be graded in such a manner that the land will drain to a public facility for the disposal of floodwater.

Chapter 8 Summary

Eminent domain is the right by which the federal government, the state, or any agency of the state may take private property belonging to any individual, providing the property taken is intended for public use and the owner is compensated.

Police power is the right by which the state may destroy, impair the value of, limit the use of, or otherwise invade property rights to protect the public health, public morals, public safety, or the general welfare. The owner receives no compensation.

The local governing body (City Council or County Board of Supervisors) has the power to pass ordinances establishing zones within which improvements must conform to certain use limitations. The right to zone comes under the rights defined under the police power of the government for the preservation of protection of public health, safety, morals, or general welfare.

Police power regulations have three limitations:

1. Must be uniform in application.
2. Must be nondiscriminatory.
3. Must be for the public welfare.

Many of these regulations control the use of property, such as zoning or the sale of certain types of property, e.g., an establishment serving alcoholic beverages. Common zoning codes are: A1-Agricultural, R1-Residential, R3-Multi Family Residential, C1-Commercial, M1-Manufacturing.

The procedure for new construction or building alterations requires an initial application to the local building department for a building permit. The application must be accompanied by plans, specifications, and plot plan.

A **condominium** is an estate in real property that consists of an undivided interest in common in a portion of real property, coupled with a separate interest in space called a unit, the boundaries of which are described on a recorded final map, parcel map, or condominium plan. Upon written request of the owner of a lot or unit in a common ownership subdivision, the governing body of such subdivision must provide that owner a copy of the declaration of restrictions, bylaws, and articles of the corporation within 10 days.

Accretion is an addition to land from natural causes, such as from gradual action of the ocean or river waters.

Avulsion is a loss of land due to the tearing away of the banks next to a river or watercourse (also called erosion).

Potable water refers to drinkable or purified water.

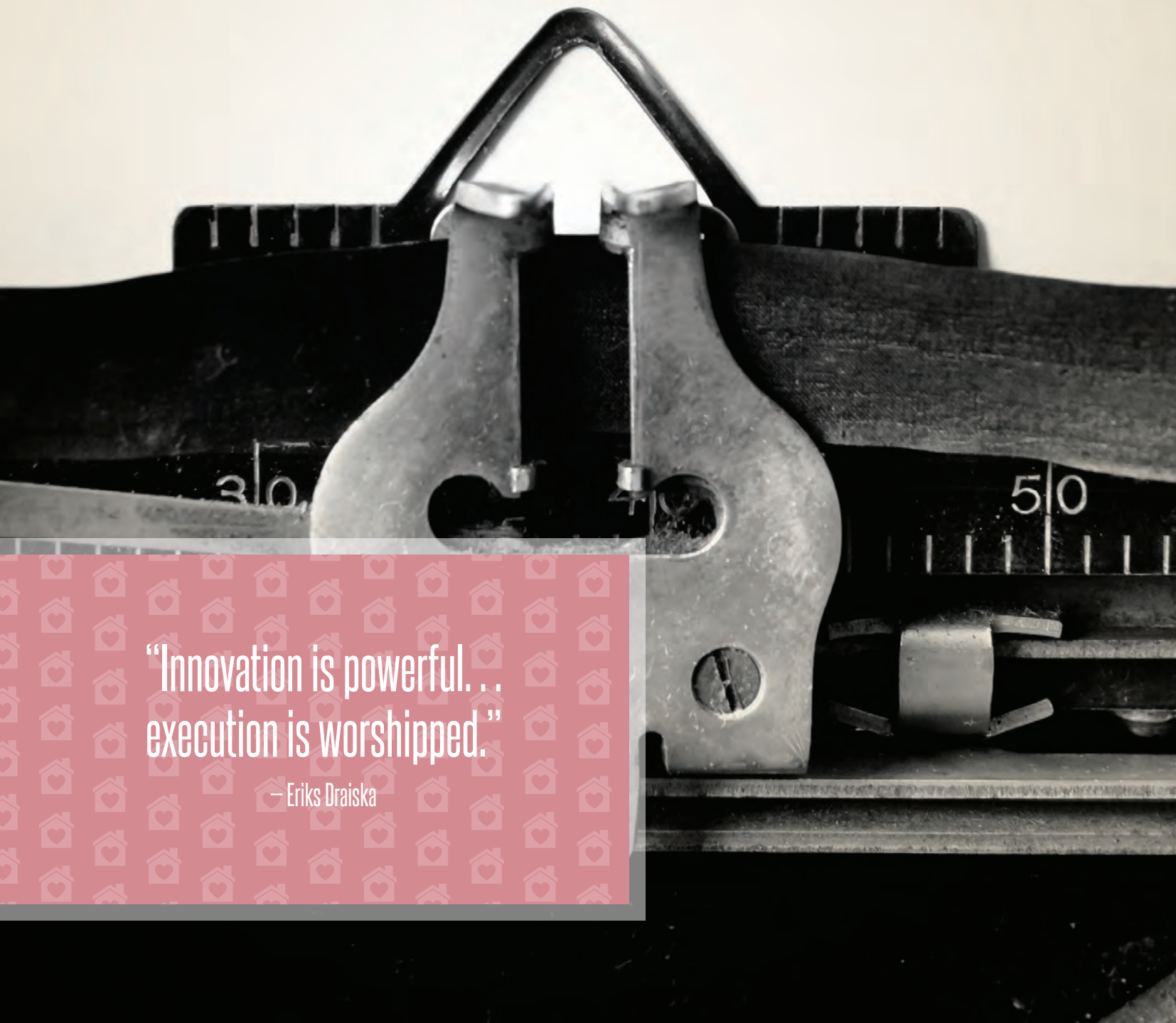
A **blanket encumbrance** is one that is secured by more than one parcel of property. One blanket mortgage (trust deed) may initially cover an entire tract. As individual houses are sold to various buyers, a partial release (release clause) is usually obtained from the blanket loan. In California, the document commonly used is a partial reconveyance deed.

notes:

chapter 8 quiz

- 1. When a public agency takes private property for public use, it is an exercise of:**
 - a. Police power.
 - b. Eminent domain.
 - c. Neither A nor B.
 - d. Both A and B.
- 2. The police power of government would include all of the following, except:**
 - a. Condemnation.
 - b. Zoning.
 - c. Building regulations.
 - d. Subdivision controls.
- 3. State law requires that every city or county create a Planning Commission:**
 - a. When funds have been appropriated by the local governing body.
 - b. Without exception.
 - c. After a master plan has been approved.
 - d. Membership of which must be comprised of at least three members of the City Council or County Board of Supervisors.
- 4. California requires that every city and county must adopt a comprehensive long-term general plan (master plan) to guide the future development of:**
 - a. Proposed major thoroughfares and transportation routes.
 - b. The general distribution and location and the extent of the uses of land for residential, commercial and industrial purposes.
 - c. The identification and appraisal of potential seismic hazards.
 - d. All of the above.
- 5. Zoning changes may be initiated by:**
 - a. Subdividers.
 - b. Local authorities.
 - c. Individuals.
 - d. All of the above.
- 6. The following is an example of police power:**
 - a. The taking of real property in order to widen a freeway.
 - b. Deed restrictions.
 - c. Zoning.
 - d. Income taxes.
- 7. An area of a city that was previously zoned for commercial use has just recently been rezoned for R 1 residential uses. This would be an example of:**
 - a. Density zoning.
 - b. Spot zoning.
 - c. Downzoning.
 - d. Split zoning.
- 8. The basic regulation and control of the housing and construction industries in California is accomplished through:**
 - a. Local building codes.
 - b. State Housing Law.
 - c. State Contractors License Law.
 - d. All of the above.
- 9. When applying for a loan, the following would not cause the building to be labeled "substandard":**
 - a. The heating system is inadequate.
 - b. Some of the rooms are damp.
 - c. At the time the building was constructed a permit was pulled for the electrical system. Today it is fully functional, but does not conform to current code requirements.
 - d. Exterior walls are not adequate to stop the entry of moisture.
- 10. The Subdivision Map Act provides for:**
 - a. Submission of proposed sales contracts for subdivision lots to the governing body for approval.
 - b. Execution of an improvement contract between subdivider and city.
 - c. Delivery of a copy of the Real Estate Commissioner's report to all prospective purchasers.
 - d. Release clauses in all blanket mortgages on subdivision property.

Discrimination



“Innovation is powerful. . .
execution is worshipped.”

—Eriks Draiska

CHAPTER 9:

respa & discrimination

Learning Objectives

Discrimination and disclosure are two of the most important topics in the real estate industry. This chapter deals with the various types of discrimination found in working in the real estate field. We detail specific federal and state laws enacted to protect the consumer not only when purchasing or renting real estate but also during everyday business transactions.

Disclosure of important information about a property is not only required in most residential transactions but also by many of the businesses that deal with the client throughout their real estate business. Knowledge of the many disclosure regulations that apply to real estate is essential for the protection of the agent and the consumer.

key terms

Blockbusting	Fair Credit Reporting Act	Regulation Z
CCRAA	Federal Trade Commission	REIT
CFPB	HELOC	RESPA
Civil Rights Act of 1968	Holden Act	Rumford Act
Closing Disclosure	HUD	Steering
Department of Corporations	HUD-1	Subprime Mortgage
DFEH	Jones vs. Mayer	TRID
Dodd-Frank Act	Limited Partnership Act	Truth in Lending Act (TILA)
Equal Credit Opportunity Act	Loan Estimate	Unruh Civil Rights Act
EZ Doc	Redlining	

Discrimination in the Sale and Rental of Residential Real Estate

Race restrictions in deeds, along with prohibiting the use or occupancy of real property because of a person's race, color, sex, religion, ancestry, marital status, national origin, or physical handicap are not enforceable under federal or state laws. All of the above are in violation of the Fourteenth Amendment to the Constitution.

Federal Regulations

The **Civil Rights Act of 1968** became fully operational in 1970 (Titles VIII, IX and XL are often referred to as the Open Housing or Fair Housing laws). Congress attempted to establish that in the sale and rental of housing, all persons are to be treated equally. All people are to be "color blind" in matters involving the sale or rental of such housing.

If the U.S. Attorney General would have reasonable cause to believe that any group of persons has been denied any of the rights granted by this law and where this denial raises an issue of general public importance, the Attorney General may act in the appropriate United States district court. If the Department of Housing and Urban Development reports a violation, the Attorney General must take action.

Later, in 1968, in the case of **Jones vs. Mayer**, the United States Supreme Court reaffirmed the constitutionality of what is now recalled as the Civil Rights Act of 1866. This earlier legislation was founded on an interpretation of the Thirteenth Amendment to the United States Constitution that abolished slavery in this country.

Administrative authority in matters involving discrimination in the sale and rental of housing is referred to the **Department of Housing and Urban Development** (HUD). This federal law establishes that complaints of violations are to be made to HUD within 180 days of the alleged discriminatory act.

If the complaint is not acted upon within 30 days of being filed with the Secretary, then the aggrieved party may commence a civil action in any appropriate United States district court against the party named in the complaint, if there are no state or local fair housing laws that provide remedies similar to those provided by this federal law.

This federal law also provides that the injured party may act to enforce the rights it bestows on private persons by initiating a civil action in any appropriate federal, state or local court to recover damages for the alleged discriminatory act. Under this federal law, the aggrieved parties might recover such actual damages that they are found to suffer, plus not more than \$1,000 in additional punitive damages together with court costs and reasonable attorney fees. Since this is a civil action, no criminal penalties are available.

The Department of Housing and Urban Development (HUD) requests that all real estate agents display the identifying logo shown below as identification that they cooperate with the rules and regulations of the department.



Equal Housing Opportunity

It should be noted here that acts of discrimination should not be confused with acts of good business. For example: Should a broker refuse to take a listing from a member of a minority group because the seller wanted to list the property well above the market, this would not be an act of discrimination.

By contrast, if an owner asks the listing broker the ethnic background of a person offering to buy the property, the broker is prohibited by law from disclosing this fact.

Credit Reporting Agencies

Another of the federal safeguards that has been established to protect an individual's right and ability to purchase desirable housing accommodations is the **Fair Credit Reporting Act** passed in 1970. Its purpose is to safeguard individual homebuyers by demanding that the information presented in credit reports be accurate and relevant. It also requires that those firms receiving credit reports must not only treat the information given confidentially, but they must use it only for the purpose for which it was obtained.

A good credit rating is one of the most valuable assets a person can have. If credit is denied because of the information given in the credit report, the applicant must be informed about it. Individual persons can request an examination of their files at the credit reporting agency. The individual must be permitted to correct any errors in such reports and to file explanatory statements regarding any derogatory information in the credit reporting agency's files. The federal agency responsible for administering this act is the **Federal Trade Commission** in Washington, D.C.

Credit Granting Agencies

In 1974, Congress passed another law in this subject area: **The Equal Credit Opportunity Act**. The purpose of this law is to forbid mortgage lenders from discriminating against borrowers in making loans because of the person's race, color, religion, national origin, sex, or marital status, or because all or part of the applicant's income is from a public assistance program.

This law is implemented through Regulation B of the Board of Governors of the Federal Reserve, and it is often referred to only as Regulation B. Certain inquiries cannot be made of borrowers. Lenders may not automatically reject part-time income when establishing a prospective borrower's total income. They must make a judgment as to the possibility of the part-time income continuing in the future.

Lenders are not allowed to assume that pregnancy will prevent a woman's employment. This law, in effect, requires lenders to give equal weight to a woman's income when considering loan approvals. Borrowers must be made aware of their rights in these matters prior to submitting their application for credit. The applicant must be notified of the lender's action within 30 days after receiving the completed credit application, and, if credit is denied, the applicant must be notified of the reason for rejection.

California Law

In California, the legislature's first attempt to legally eliminate racial discrimination in the workplace was to pass the **Unruh Civil Rights Act** of 1959. This law established that it is against public policy in the State of California for the proprietor of a business to discriminate in their business activity because of a customer's race, color, etc. It also establishes that the same business operators could not discriminate in the hiring and firing of their employees for the same or similar reasons.

This Unruh Act now provides that any violation of its provisions can be penalized by requiring the payment of:

- ▣ Actual damages suffered by the injured party.
- ▣ Punitive damages of three times the actual damages but no less than \$250.
- ▣ Attorney's fees as determined by the court.

In 1963, the California Legislature went further in this matter and passed what is called the **Rumford Act**. This law applies the principles established by the Unruh Act to the sale and rental of housing. Under this law, injured persons can file a complaint with the **Department of Fair Employment and Housing (DFEH)** within 60 days of the alleged discriminatory act.

After a hearing by the Fair Employment and Housing Commission, if it finds the accused to be guilty of an unlawful practice, they are to state their findings and issue an order requiring the accused person to cease and desist from such practices and to do one of the following:

- Complete the sale or rental of the housing accommodation if it is still available, or the sale or rental of a like housing accommodation if one is available.
- Pay punitive damages not to exceed \$1,000.
- Pay any actual damages suffered by the injured party.

The next step taken by the California Legislature was to enact the Housing Financial Discrimination Act of 1977. Since 1982, this law has been known as the **Holden Act**. Its purpose is to try to prevent the kind of discrimination that can be practiced by lending institutions while processing loans for financing and refinancing the purchase, construction, rehabilitation, or improvement of housing accommodations. Lenders have been known to make their lending decisions based upon the conditions, characteristics, and trends in the neighborhood or geographic area surrounding the property offered as security for the loan, rather than on the value of the property itself and on the credit worthiness of the prospective borrower. In the real estate business, such a practice is called **redlining**. In effect, this law determined that the lending practice just described is against public policy in California and is prohibited by law.

By these laws, an attempt was made:

- To encourage increased lending in neighborhood or geographic areas in which conventional residential mortgage financing had been unavailable.
- To increase the availability of housing to credit-worthy persons.
- To ensure the supply of decent and safe housing.
- To prevent the abandonment and decay of certain neighborhoods and geographic areas.

Under the provisions of this law, the term housing accommodation means any improved or unimproved real property or portion of the same:

- That is used or is intended to be used as a residence, and
- That is or will be occupied by the owner, and
- That contains not more than four dwelling units.

California law provides that it is unlawful for the owner of a publicly assisted housing accommodation to discriminate in the sale or rental of such accommodation because of a person's race, color, religion, sex, marital status, ancestry, or national origin. In this circumstance, a publicly assisted housing accommodation would include an improved property that is granted an exemption in whole or in part from taxes (except veterans) and an improved property on which the improvements were constructed on land sold below cost by the state or any of its political subdivisions or agency thereof under the Federal Housing Act of 1949. Another exception is an improved property that is financed in whole or in part by a government agency.

The provisions include any residential dwelling containing not more than four dwelling units where the owner, whether or not he/she or she will occupy the property, applies or has applied for a secured home improvement loan from a financial institution that will be used to improve the security property.

The law further establishes that complaints of violations of this law are to be made to the Secretary of the Business and Transportation Agency of the State of California. Any violations can be punished by a damage claim against the lending institution, not to exceed \$1,000 for each offense.

Lending Institutions

Lastly, you must understand another California law, the **Consumer Credit Reporting Agencies Act (CCRAA)**, which became a law in 1970. The purpose of this law was similar to that of the Federal Fair Credit Reporting Act of the same year. This California law established the means by which a person who is denied credit or denied an opportunity for employment because of information supplied by a credit reporting agency may proceed to correct the matter. The consumer must be given the name, address, and/or addresses of the consumer credit reporting agency or agencies making the report. The consumer must also be told the nature and substance of adverse information.

Under this law, any applicant who suffers damages as a result of a violation of the law may bring an action in court to recover attorney's fees and, when applicable, pain and suffering from the offending party. In the case of a willful violation:

- Actual damages as shown above.
- Punitive damages of not less than \$100 nor more than \$5000 for each violation as the court deems proper.
- Any other relief that the courts deem proper.

The prevailing parties in any action commenced under the authority of this law may also recover court costs and reasonable attorney's fees.

Federal Consumer Credit Protection Act

Truth in Lending

The **Truth in Lending Act** became effective July 1, 1969. The principal purpose of this act is to promote the informed use of consumer credit by requiring creditors to disclose credit terms in order to enable consumers to make comparisons between various credit sources. To implement the act, the Board of Governors of the Federal Reserve System issued a regulation known as **Regulation Z**.

In 1980, Congress amended the act by passing the Truth in Lending Simplification and Reform Act. To reflect the amendment to the act, the Federal Reserve Board substantially revised Regulation Z in compliance with the simplified act, and the revised Regulation Z became mandatory in 1982.

Under this law, the creditor is responsible for furnishing truth in lending disclosures to the consumer. Regulation Z now defines a creditor as any person who extends consumer credit more than 25 times a year or more than five times a year for transactions secured by a dwelling. The transaction is limited to loans repayable in five or more installments. The credit extended must be subject to a finance charge or be payable by written agreement in more than four installments. Another requirement is that the obligation be initially payable on its face or by agreement to the person extending the credit. Because of provisions in the Garn St Germain Depository Institutions Act of 1982, the Federal Reserve Board amended the revised Regulation Z by removing “arranger of credit” from the “creditor” definition. This action by the Board releases real estate brokers or other arrangers of credit from the responsibility for providing disclosures unless these persons otherwise come within the definition of creditors.

Regulation Z specifically excludes credit reports and appraisal fees from the finance charges that are to be disclosed to the borrower on a real estate loan.

There are two basic types of transactions that are exempt from coverage under Regulation Z. The first is for credit extended primarily for business, commercial, or agricultural purposes. The second is for credit over \$25,000. This dollar limitation does not apply if the loan is secured by real property or by personal property that is used or is expected to be used as the consumer’s principal residence (mobilehome).

Regulation Z requires all truth in-lending (TIL) disclosures concerning the credit sale or loan to be grouped together and segregated from other information. In addition, it also requires that the terms “finance charge” and “annual percentage rate” be more conspicuous than other required disclosures. The portion of the sale or loan documents that contains these disclosures is commonly called the federal box. Under revised Regulation Z, the TIL disclosures must be separate from everything else but may be continued from one page to another.

A creditor is only required to make those disclosures that are relevant to a particular transaction. The disclosure statement must have simple descriptive phrases next to five of the most important items disclosed. These items include the amount financed, the finance charge, the annual percentage rate, the total of payments and, in credit sales, the total sale prices.

Real Estate Settlement Procedures Act (RESPA)

Congress enacted the **Real Estate Settlement Procedures Act** or **RESPA** in 1974. They later amended the law in 1976. The purpose of this legislation was to give consumers enough information at an early enough time to permit shopping in the marketplace for the best settlement services and costs in transactions involving the purchase of one-to-four family residential real estates. Creditors involved in residential mortgage transactions subject to RESPA are required to make Regulation Z disclosures before consummation or to deliver or place them in the mail within three business days after receiving the consumer's written application, whichever is earlier. If the estimates turn out to be inaccurate, it may be necessary to make another disclosure at consummation. Two events occurring after consummation that require the creditor to make new disclosures are a refinancing or an assumption. RESPA forbids those who must present the Disclosure Settlement Statement to their borrowers from charging a fee for the preparation of the form.

The consumer has the right to rescind until midnight of the third business day following the last of these events to occur: consummation of the transaction, delivery of all material TIL disclosures, or delivery of the notice of right to rescind. A business day is any calendar day except Saturdays, Sundays, and federal legal holidays.

As a general rule, the rights of rescission apply to all consumer credit transactions where the obligation is secured by a lien against the consumer's principal dwelling. Since the definition of a dwelling is not limited to real property, transactions involving mobilehomes can be rescindable even if they are treated as personal property under state law.

There are a number of important exceptions to this right to rescind that are applicable to residential real estate transactions. One exemption concerns residential mortgage transactions. Under this exemption, the right of rescission does not apply to transactions made to finance the acquisition or initial construction of the consumer's principal dwelling and secured by that dwelling, regardless of lien status. Hence, second mortgages for the purpose of financing an acquisition are no longer subject to the right of rescission. Another exemption is for refinancing, by the same creditor, of a loan already secured by the principal dwelling, provided no new money is advanced. If new money is advanced, the transaction is rescindable to the extent of the new money if the loan is secured by the consumer's principal dwelling.

The consumer is allowed by law to waive the right to rescind if he/she or she determines that the extension of credit is needed to meet a bona fide personal financial emergency. This must be done on a dated, written form.

One placing an advertisement for consumer credit must comply with the advertising requirements of the Truth in Lending Act and Regulation Z. Therefore, real estate brokers and homebuilders who advertise credit terms must comply, even if they are not creditors in the financing being advertised. Disclosures in credit advertisements must be made "clearly and conspicuously." If the finance charge in a credit advertisement is expressed as a rate, it must be stated as an "annual percentage rate," using that term. Prices cannot be advertised as a percentage of a non expressed value.

An advertisement for a variable rate mortgage with an initial annual percentage rate of 3% that may vary after settlement without any limit could be advertised as “3% annual percentage rate subject to increase after settlement.” This may not be used in advertisements of graduated payment mortgages that have a fixed interest rate and payments that increase during the loan. Such mortgages involve different interest rates in effect during the life of the loan. This kind of mortgage note often creates a negative amortization, increasing the amount of the loan instead of paying it off. A variable rate transaction involves future interest rates unknown at settlement.

If only the annual percentage rate is disclosed in advertising, additional disclosures are not required. If an advertisement contains any one of the following terms, then the ad must also disclose other credit terms: the amount or percentage of any down payment; the number of payments or period of repayment; the amount of any payment; the amount of any finance charge.

An advertisement that states “100% financing” requires no further disclosures because no down payment is required.

The **Federal Trade Commission** is charged with the enforcement of the Truth-in Lending Act and Regulation Z with respect to real estate brokers, mortgage loan brokers, and mortgage bankers. In the event of conviction for a violation, a creditor may be liable to a consumer for a statutory penalty of twice the amount of the finance charge, with a minimum of \$100 and a maximum of \$1,000. This statutory liability applies only to seven specific violations.

A creditor is also subject to a fine of not more than \$5,000 or imprisonment for not more than one year, or both, for willfully and knowingly violating the TIL Act or Regulation Z by giving false or inaccurate information, failing to provide required disclosures, or consistently understating the annual percentage rate.

Redlining

When lending institutions attempt to limit their liability for loans by restricting their loans on real property only to those neighborhoods where the more affluent, credit-responsible homeowners are to be found, the practice is called **redlining**. The name came from the practice of drawing a red line on a map and not making loans on the side that the lending institution had determined to be racially or ethnically undesirable.

Blockbusting

Blockbusting is a form of discrimination that has been practiced since the early 1930's. It takes on many forms, the most basic of which is the persuasion of homeowners in a neighborhood to sell because buyers of a different racial or ethnic heritage were moving into the area.

The practice in the early days went so far as to have an unscrupulous agent actually sell a home to a large family of a racially different heritage in a totally Caucasian neighborhood. When the neighbors saw the children playing in the street, they sold in panic, believing that their home values would radically drop. The agent would then buy the “panic sold” homes and move the blockbusting family out of the property they had occupied.

Steering

Steering is the practice of driving a buyer only to neighborhoods where the homeowners were not bigoted about having a person of a different heritage living in the community. The agent literally steers his/her automobile into neighborhoods that are racially and ethnically mixed.

RESPA was signed into law in December of 1974 and became effective on June 20, 1975. The Act was intended to give the homebuyer more information about settlement procedures and costs. However, in the view of many consumers, lenders, and others, RESPA created more problems than it solved. Congress quickly responded by amending RESPA after it had been in operation for only six months. The provisions of RESPA as amended became effective on June 30, 1976.

RESPA covers mortgages and trust deeds on one-to-four family homes, including mobilehomes, condominiums, and cooperatives financed by a federally regulated lender as defined in the act. This includes:

- ▢ Loans made through FHA or VA, or with other government assistance.
- ▢ Loans from financial institutions with FDIC or FSLIC insurance on deposits.
- ▢ Loans eligible for purchase by FNMA or other federal secondary mortgage market institutions.
- ▢ Loans from a creditor who makes or invests more than \$1,000,000 a year in residential loans.
- ▢ A loan to finance the acquisition of title to covered property being purchased by a land sales contract.
- ▢ A loan secured by a first lien or other first security covering real estate, including a fee simple, life estate, remainder interest, ground lease, or other long-term leasehold estate.

RESPA exempts the following transactions:

- ▢ Junior mortgages and trust deeds.
- ▢ A loan to finance the purchase or transfer of a property of 25 or more acres.
- ▢ A home improvement loan, a loan to refinance, or any loan not used to finance the purchase or transfer of the legal title to the property.
- ▢ A loan to finance the purchase or transfer of a vacant lot where no proceeds of the loan are to be used for the construction of a one-to-four family residential structure or for the purchase of a mobilehome to be placed on the lot.
- ▢ Assumption, renovation, or sale subject to a pre existing loan, except where a construction loan is used as or converted to a permanent mortgage/trust deed to finance a purchase by the first user.
- ▢ A construction loan to a developer.
- ▢ A permanent mortgage/trust deed loan on a lot already owned where the proceeds are used to finance the construction of a one-to-four family structure (or for any other purpose).

- A loan to finance the purchase of a property when the primary purpose of the purchase is for resale.
- Execution of a land sales contracts where the legal title is not transferred to the purchaser upon execution.

TRID

Most home buyers require third-party bank financing to purchase a home. Regardless of whether a licensed agent acts as a mortgage broker, a listing agent, a buyer's agent, a dual agent, or all of the above, agents should learn more information about the **TRID** disclosure form's impact on the sales and escrow transaction.

The rules and guidelines tied to mortgage finance have changed significantly in recent years after the turmoil in the financial and real estate markets began after 2007 and 2008. There were millions of foreclosed properties in California alone after 2008, and possibly tens of millions of foreclosed or distressed properties nationwide.

Due to allegations of mortgage fraud on a large-scale basis nationally as partly tied to **EZ Doc** and **subprime mortgage** credit loans, the TRID mortgage guidelines took effect in October 2015. The origins of TRID date back to the Dodd-Frank Wall Street Reform and Consumer Protection Act (also known as **Dodd-Frank Act**) as the federal government worked diligently trying to save and boost the financial markets at the same time.

The Dodd-Frank Act: President Barack Obama signed this act on July 21, 2010. One of the main purposes for the creation of this act was to try to improve the disclosure forms for borrowers or consumers partly so that they better understood what types of loans they were borrowing from their lender.

Under the Dodd-Frank Act, the **Consumer Financial Protection Department (CFPB)** was created. CFPB is an independent federal governmental agency that focuses on consumer protection in the financial industry sector. CFPB regulates small and large financial firms such as credit unions, banks, securities firms, debt collection companies, payday and other hard money lenders, and even foreclosure assistance or other debt relief businesses.

TRID is an acronym of two other acronyms - **TILA** (Truth-in-Lending Act) and **RESPA** (Real Estate Settlement Procedures Act). TRID is also the Consumer Financial Protection Department's "Know Before You Owe" TILA-RESPA Integrated Disclosure form. TRID is effectively a merger of the old TILA and RESPA disclosure forms.

TRID consolidated four of the most well-known national mortgage disclosure forms into just two new forms. The four old forms which were replaced by TRID include these below:

1. Good Faith Estimate
2. Initial Truth-in-Lending Statement
3. HUD-1
4. Final Truth-in-Lending Statement

After October 2015, the Good Faith Estimate and the Initial Truth-in-Lending Statement were combined to become the new **Loan Estimate** form. The **HUD-1** and Final Truth-in-Lending Statement were merged to become the **Closing Disclosure** form.



Loan Estimate Statement:
<http://lumbleau.com/loan-estimate-statement>



Closing Disclosure Statement:
<http://lumbleau.com/closing-disclosure-statement>



TRID Guidelines:
<http://lumbleau.com/trid-guidelines>



Mortgage loans which are impacted by TRID disclosure guidelines include most types of closed-end mortgage loans secured by residential properties.

These types of mortgages which may be excluded or exempt from TRID disclosure mortgage rules includes **HELOCs** (open-ended Home Equity Lines Of Credit), reverse mortgages, and mobile or manufactured homes that are not permanently attached to the land.

The new Loan Estimate form provides consumers or prospective mortgage borrowers with much more specific and detailed potential mortgage payment amounts as well as much more exact amounts of cash needed to close escrow. In previous transactions before TRID, the older Good Faith Estimate forms did not always provide the most accurate information for mortgage borrowers regarding proposed mortgage payment amounts and cash needed to close. Many times, real estate deals later terminated during the loan contingency time periods after borrowers were shocked to find out how high that the mortgage payments, down payments, and/or closing costs would be to close the escrow.

There are much shorter delivery times required for the Loan Estimate and Closing Statement. These times can vary between just three and seven business days, depending upon several factors.

Kickbacks or Unearned Fees: The law prohibits any person from giving or accepting any type of compensation unless a service was actually performed to earn it. The law does not prohibit the payment of reasonable salary or compensation for services actually performed. Specifically permitted are payments pursuant to cooperative brokerage and referral arrangements between real estate brokers. Violators are subject to criminal penalties (\$10,000 fine or one year's imprisonment) and liability up to three times the value of the illegal compensation in each suit, plus court costs and attorney's fees.

RESPA now prohibits a lender from requiring escrows for taxes, insurance, and other charges in excess of the amount of money needed to make a specific payment, plus an amount equal to two months payments for such charges.

No seller (primarily builders and developers) may directly or indirectly require a buyer to purchase title insurance from a particular company. Violators are subject to a penalty of three times the charges for the insurance.

The buyer has the right to select a specific loan provider. RESPA is administered by the CFPB.

Real Estate Investment Trusts (REITS)

In 1960, the Real Estate Investment Trust Act, enacted by the U.S. Congress, added sections to the Internal Revenue Code. The Act became effective January 1, 1961. A real estate investment trust (**REIT**) is an unincorporated trust or association of at least 100 investors owning real property or mortgages. In actual fact, a real estate investment trust is an entity that can do business to some degree as if it were a corporation. Were it not for the tax exemption provided by law, the REIT would be taxed as a corporation. Investors become shareholders in these trusts. Although unincorporated, the Commissioner of Corporations has full supervisory powers over REIT's.

A purpose of a REIT was to enable small investors to pool their individual funds to take advantage of big investment opportunities and tax benefits.

Real estate investment trusts are yet another example on the part of the federal government to create a climate in which ordinary American citizens might be able to accumulate a measurable amount of wealth.

Three Types of REIT's

1. Equity Trusts: This type of trust is involved essentially in the ownership of real property, and its chief source of income is rent and the offset of inflation.
2. Mortgage Trusts: In this case, the assets are invested in short term or long-term mortgages or other liens against real property. Thus, they lend money and receive income in the form of interest.
3. Combination Trusts: Combination trusts may develop property, own property, lease property, provide mortgage financing, and make land development loans, etc. Income is derived from both rent and interest.

Basic Requirements to Qualify Under the Federal Law

- ▢ Must not hold property primarily for sale to customers in the ordinary course of business.
- ▢ Must be beneficially owned by at least 100 investors.
- ▢ No five persons or fewer may hold more than 50% of the beneficial interest.

This “beneficial interest” must be evidenced by transferable shares or certificates of interest.

In California, there are further limiting provisions that each share or certificate of interest carries with it an equivalent vote in determining trust policy. It is this structure that has so far controlled the development of trusts in this state.

Investments must account for a minimum of 95% of the trust's gross income.

75% of gross income must come from real estate investments.

Less than 30% of the trust's gross income may result from short-term gains on sales of stock or securities held for less than one year, plus sales (but not involuntary conversions) of real estate held for less than four years.

At least 95% of a trust's net income must be distributed to the shareholders each year.

Real Estate Syndication

Real estate syndication offers the opportunity to channel private savings into real estate investments for which other financing would not be available. From time to time, it has been a popular method used to finance the purchase and sale of properties in the higher price ranges.

The term syndication has no precise legal significance. It is a descriptive term for an organization or combination of investors pooling capital for investment in real estate. The responsibility, obligation and relationship of the syndication to the investment group and the investors to each other are determined principally by the form of entity utilized.

General Provisions

A typical real estate syndication combines the money of individual investors with the management of a sponsor and has a three phase cycle:

1. Origination: planning, acquiring property, satisfying registration and disclosure rules, and marketing.
2. Operation: sponsor usually operates both the syndicate and the real property.
3. Liquidation or completion: the resale of the property.

Many syndications involve a limited partnership in which the investors providing the funds are the limited partners and the sponsor providing the management is the general partner. A general partnership would be inadvisable since all partners would become individually liable for the entire debts of the partnership.

Advantages

Virtually every real estate broker or developer has been at some time in a controlling position with respect to an expensive piece of property that appears to offer extremely favorable opportunities for profit to the purchaser. All too often, the investment outlay on such a purchase is more than any single client can manage. The real estate licensee who understands the methods of syndication can turn what would otherwise have been a frustrating and unrewarding situation into a profitable transaction for both the licensee and the investors. Leverage is the key ingredient. One person joining others to invest in a large syndicate may receive a return on invested capital in excess of that which can be obtained through individual purchases.

By pooling limited financial resources with others who are similarly situated, a small scale investor is afforded an opportunity to participate in ownership and operation of a piece of property that is too much to handle singly or in a joint venture with one or two others. This affords liquidity to participants because their shares are transferable on the market or through the trust.

Often, more than one property is involved with a syndication. The blind pool syndication buys and sells multiple properties, with the investors having little or no knowledge of the properties being purchased or sold until the annual report is issued.

Syndication offers professional management that would not otherwise be economically available to the small investor. Professional management is at the heart of nearly every successful syndication. It is the basic commodity that the syndication, or sponsor, has to offer, and it is the ingredient that is lacking in the income property investment that is small enough to be owned by a single owner or by a joint venture of a few investors with limited resources.

Syndicate Forms

The entity selection involves practical as well as legal and tax considerations. Each of the available entities offers advantages as well as disadvantages. The corporate form ensures centralized management along with limited liability for the investors but is seldom utilized in modern syndicates because of its negative tax features. The general partnership (joint venture) avoids the double taxation normally involved in a corporate entity, but the unlimited liability provision and lack of centralized management militate against its use. The limited partnership combines nearly all of the advantages of the corporate and partnership forms. It has the corporate advantages of limited liability and centralized management, and the tax advantages of the partnership. Consequently, the limited partnership form of organization is the one most frequently selected for real estate syndicates.

The application for the sale of real estate syndicate securities must be submitted to the Commissioner of Corporations and be accompanied by the appropriate fee.

Limited Partnership

Under the California **Limited Partnership Act**, a limited partner is not liable as a general partner unless the limited partner is named as a general partner in the Certificate of Limited Partnership, or the limited partner participates in the control of the business. If the limited partnership agreement otherwise qualifies, the limited partnership is taxed as a partnership rather than as an association taxable as a corporation.

Regulatory Control of Real Estate Syndicate Offerings

In California, jurisdiction over all real estate syndicate offerings is placed in the **Department of Corporations**. Real estate brokers are permitted to engage in the sale of real estate syndicate security interests.

Chapter 9 Summary

Steering is an illegal activity of a property manager or real estate agent showing clients properties in only a select neighborhood which may reflect their client's own race, religious preferences, or other similar backgrounds.

When lenders restrict their loans on real property only to those neighborhoods where the more affluent, credit-responsible homeowners are to be found, the practice is called **redlining**. The name came from the practice of drawing a red line on a map and not making loans on the side that the lending institution had determined to be racially or ethnically undesirable.

Blockbusting is a form of discrimination that has been practiced since the early 1930's. It takes on many forms, the most basic of which is the persuasion of homeowners in a neighborhood to sell because buyers of a different racial or ethnic heritage were moving into the area.

In the case of **Jones vs. Mayer** in 1968, the U.S. Supreme Court reaffirmed the constitutionality of the Civil Rights Act of 1866. This earlier legislation was founded on an interpretation of the Thirteenth Amendment to the United States Constitution that abolished slavery in this country.

The **Civil Rights Act of 1968** became fully operational in 1970 (Titles VIII, IX and XL are often referred to as the Open Housing or Fair Housing laws). Congress attempted to establish that in the sale and rental of housing, all persons are to be treated equally. All people are to be "color blind" in matters involving the sale or rental of such housing.

In 1963, the California Legislature went further in this matter and passed what is called the **Rumford Act**. This law applies the principles established by the **Unruh Act** to the sale and rental of housing. Under this law, injured persons can file a complaint with the **Department of Fair Employment and Housing (DFEH)** within 60 days of the alleged discriminatory act.

The **Unruh Act** provides that any violation of its provisions can be penalized by requiring the payment of:

- ▣ Actual damages suffered by the injured party.
- ▣ Punitive damages of three times the actual damages but no less than \$250.
- ▣ Attorney's fees as determined by the court.
- ▣ Complete the sale or rental of the housing accommodation if it is still available, or the sale or rental of a like housing accommodation if one is available.
- ▣ Pay punitive damages not to exceed \$1,000.
- ▣ Pay any actual damages suffered by the injured party.

The **Truth in Lending Act** became effective July 1, 1969 to promote the informed use of consumer credit by requiring creditors to disclose credit terms in order to enable consumers to make comparisons between various credit sources. To implement the act, the Board of Governors of the Federal Reserve System issued a regulation known as **Regulation Z**. The **Federal Trade Commission** is charged with the enforcement of the Truth-in Lending Act and Regulation Z with respect to real estate brokers, mortgage loan brokers, and mortgage bankers. In the event of conviction for a violation, a creditor may be liable to a consumer for a statutory penalty of twice the amount of the finance charge, with a minimum of \$100 and a maximum of \$1,000.

TRID is an acronym of two other acronyms - **TILA** (Truth-in-Lending Act) and **RESPA** (Real Estate Settlement Procedures Act-1974). TRID is also the Consumer Financial Protection Department's "Know Before You Owe" TILA-RESPA Integrated Disclosure form. RESPA covers mortgages and trust deeds on one-to-four family homes, including mobilehomes, condominiums, and cooperatives financed by a federally regulated lender as defined in the act.

TRID consolidated four of the most well-known national mortgage disclosure forms into just two new forms. The four old forms (1. Good Faith Estimate, 2. Initial Truth-in-Lending Statement, 3. HUD-1, 4. Final Truth-in-Lending Statement) were replaced in October 2015 to become the new **Loan Estimate** form and the **Closing Disclosure** form.

Administrative authority in matters involving discrimination in the sale and rental of housing is referred to the Department of Housing and Urban Development (**HUD**). Federal law also provides that the injured party may act to enforce their rights by initiating a civil action in any appropriate federal, state or local court to recover damages including actual damages plus not more than \$1,000 in additional punitive damages together with court costs and reasonable attorney fees.

An advertisement for graduated payment mortgages with a fixed interest rate and payments that increase during the loan must be disclosed under TRID. Variable interest rate mortgages involve different interest rates during the life of the loan. This kind of mortgage note often creates a negative amortization, increasing the amount of the loan instead of paying it off. A variable rate transaction involves future interest rates unknown at settlement.

If only the annual percentage rate (**APR**) is disclosed in advertising, additional disclosures are not required. If an advertisement contains any one of the following terms, then the ad must also disclose other credit terms:

- the amount or percentage of any down payment
- the number of payments or period of repayment
- the amount of any payment; the amount of any finance charge

A real estate investment trust (**REIT**) is an unincorporated trust or association of at least 100 investors owning real property or mortgages.

chapter 9 quiz

- 1. The primary purpose of Federal Fair Housing legislation enacted in 1968 and which became fully operative in 1970 was to:**
 - a. Eliminate prejudice throughout the entire United States.
 - b. Prevent discrimination because of race, color, religion or national origin in the sale or rental of housing units.
 - c. Guarantee low cost housing throughout the United States.
 - d. Provide a plentiful supply of subsidized housing throughout the United States.
- 2. A landlord cannot require the following from a prospective tenant:**
 - a. Good credit and solid income.
 - b. References.
 - c. That unmarried (single) tenants have a co-signer.
 - d. Security deposit.
- 3. The following type of syndicate requires at least 100 participants:**
 - a. Corporation.
 - b. Real estate investment trust.
 - c. Limited partnership.
 - d. Joint venture.
- 4. Should there be a violation of the provisions of the Civil Rights Act of 1968, Title VIII Fair Housing the aggrieved person may seek relief by:**
 - a. Filing a civil action in state court.
 - b. Filing a civil action in a federal district court.
 - c. Filing a complaint with the secretary of Housing and Urban Development.
 - d. Any of the above.
- 5. The Equal Credit Opportunity Act that was enacted in 1974, was created to:**
 - a. Set uniform interest rates on real estate loans in the country.
 - b. Set minimum requirements to enable a person to make credit purchases.
 - c. Prohibit discrimination based on the sex and marital status of the credit applicant in the extension of credit.
 - d. Set uniform standards for the documents used in extending credit.
- 6. A loan broker asks a person applying for a new loan to fill out a questionnaire in which the borrower's race and marital status are requested. Applicant can:**
 - a. Refuse to disclose his/her race or marital status.
 - b. File a complaint with the real estate commissioner.
 - c. Supply the information requested so his/her credit history can be properly checked.
 - d. Do all of the above.
- 7. In California the following official enforces anti discrimination laws and seeks to assure housing accommodations for anyone no matter their race, color or creed:**
 - a. The Real Estate Commissioner.
 - b. The Director of Housing and Community Development.
 - c. The Labor Commissioner.
 - d. The Fair Employment and Housing Commission.
- 8. A real estate broker found guilty of discrimination in the leasing of an apartment, may:**
 - a. Be liable for \$250 for each offense.
 - b. Be charged actual damages.
 - c. Have his/her license revoked.
 - d. Be subject to all of the above.
- 9. Federal Truth in Lending regulations require that certain disclosures be made by creditors to buyers seeking credit in the purchase of:**
 - a. Any industrial lot.
 - b. Vacant land which he/she intends to hold for investment other than his/her residence.
 - c. Vacant land on which he/she intends to construct improvements to produce future income.
 - d. None of the above.
- 10. Under the provisions of the Real Estate Settlement and Procedures Act (RESPA), estimates of the amounts of all the following charges must be disclosed at the time of closing, except:**
 - a. Credit report.
 - b. Loan document preparation.
 - c. Appraisal fees.
 - d. Uniform settlement statement preparation costs.



“You are not buying a home. . .
you are buying a lifestyle.”

— Sarah F. Findel

CHAPTER 10:

contracts – part one

Learning Objectives

The amount of paperwork used in real estate transactions is extensive. It is important to have a thorough knowledge of the forms and how to use them. The next two chapters explain the terminology used in our contracts and when to use them. This chapter explains basic contract law terms and how they apply to listing and selling contracts. We review the different types of listing agreements and the purchase agreement.

key terms

Acceleration Clause	Executed contract	Statute of Frauds
AITD	Executory contract	Subject to
Assume	Legality	Subordination clause
Capacity	Liquidated damages clause	Valid
Consideration	Mutual consent	Void
Contingencies	Net Listing	Voidable
Covenants	Novation	
Exclusive Agency	Open listing	
Exclusive Right to Sell	Protection clause	

Contracts

A contract is defined as “an agreement between two or more persons to do or not to do something that is judicially enforceable.” It is a bilateral agreement, expressing a meeting of the minds. What they promise to do or not to do may consist of the performance or non performance of some act, or the payment of money. In the field of real estate, one of the parties promises to pay money and the other promises to perform some act, such as the transfer of title or, under an agency agreement, to procure a buyer or lessee.

Requirements for a Valid Contract

Every contract of whatever kind must meet four essential requirements before it comes into existence as a contract:

1. Mutual consent
2. Consideration
3. Capacity
4. Legality

Performance is not a necessary ingredient to create a contract. It may be a necessary ingredient to complete the terms of a contract (e.g., a listing).

Mutual consent: This requirement means that the parties to a contract must agree on the exact same thing. No contract would arise if one of the parties agreed to do one thing and the other party agreed to do something else. Because of this, all terms and conditions of a contract must be carefully drawn so that there can be no misunderstanding or misinterpretation of the exact agreement between the parties.

Consideration: The consideration necessary to make a contract binding is not the payment of money or the performance of the act agreed to. The consideration is the mutual promise in the contract to carry out its terms. The legal dictionary states consideration is “an act of the promise from which the promisor derives a benefit or advantage.” An illegal consideration would void the contract.

Capacity: Before a person may enter a binding contract, he/she or she must have the legal capacity to do so. The law limits the capacity of certain persons to enter into a contract, e.g., minors and incompetents; therefore, contracts by such persons may be void or voidable, depending on all the circumstances in each case.

Et al: Sometimes, a purchaser of a property does not wish to disclose the other purchasers and will use the phrase “et alia” or “et aliae,” which are Latin phrases commonly used in legal practice. They mean “and others.” This phrase is abbreviated very often as et al.

Legality: Before a contract can come into existence, the object of the contract must be legal or lawful. According to law, an agreement to do something prohibited by law cannot be a contract. Thus, an agreement to commit a criminal act is not enforceable. A person signing an agreement without the legal authority to do so would be committing forgery.

Current real estate contracts explicitly state that the signer should read the contents of the agreement and, on some, indicate that he/she or she has done so. When one signs a contract without reading it, and when the failure to familiarize oneself with the contents of a written contract prior to its execution is solely due to carelessness or negligence, the contract is valid. If such failure or negligence is induced by false representation or fraud of the other party to the contract so that its provisions are different from those set out orally, the court may reform the contract to reflect the true contract between the parties.

Three words constantly appear in real estate phraseology and must be understood to both enter the profession and work within the profession. The words are:

1. **Valid:** having force or binding force, legally sufficient and authorized by law, i.e., enforceable.
2. **Void:** having no force or effect, i.e., that which is unenforceable.
3. **Voidable:** capable of being adjudged void, but is not void unless action is taken to make it so. “May be avoided” is another way of expressing what voidable signifies.

Duress is unlawful constraint exercised upon a person whereby he/she or she is forced to do some act against his/her will, creating a voidable contract.

Novation

Novation is the substitution of a new debt or obligation for an existing one. For example: Two individuals entered into a long-term real estate contract. After one year had elapsed, they decided to change the contract and a new contract was executed, replacing the original one.

Amendments (Riders)

An amendment to a contract could be a rider, typically typed and attached to the contract and intended to be a part of the contract.

Real Estate Contracts

Persons entering the field of real estate act as agents and thus perform acts for or represent other persons. As an agent, the licensee will be drawing contracts for persons he/she or she represents. A real estate agent is not an attorney and is, therefore, prohibited from drawing an original contract. However, real estate agents are permitted to fill out certain printed forms. These consist of agency agreements, purchase agreements, land contracts, leases, exchange agreements, and possibly escrow instructions.

Statute of Frauds

The **Statute of Frauds** is a law requiring certain contracts to be in writing and signed before they are enforceable in a court of law. Almost all of the contracts with which a licensee in the field of real estate is involved come under this law and must be in writing or they cannot be enforced in a court of law.

The requirements of a real estate contract are no different from those of any other contract, except that most real estate contracts must be in writing. Therefore, a real estate contract is said to have a fifth characteristic to be enforceable in court (i.e., such contract must be in writing). All the requirements of contracts, in general, may be related to real estate contracts. There is one exception: In the exchange of real property, the Statute of Frauds allows oral contracts to be enforceable.

Mutual Consent

Many of the terms of the contracts dealt with by licensees are printed on the form and, except in the case where the parties may agree otherwise, will not have to be changed. There are, however, many instances where spaces will have to be filled in and somewhat lengthy terms drafted. These might consist of the method of payment of money; the time of possession of the property; pest control clauses; subordination agreements; release clauses; conditions under which the contract will become enforceable (contingencies); and many others.

These terms must be drafted carefully so that they will clearly state the agreements of the parties to avoid mistakes or the possibility of misinterpretation. If the parties enter into a contract with mutual assent as to the subject matter of the agreement, but there is a mistake as to a basic or material fact that induces one or both of the parties to enter into the contract, the contract is voidable. If a mistake does not concern a material element of the contract and does not vitally affect the facts on the basis of which the parties contracted, the mistake has no effect and the contract is valid. If a mistake is solely the result of negligence of one of the parties to the contract and there is absence of knowledge of the mistake by the other party, the courts have ruled the contract to be valid. If there is a mutual mistake as to the subject matter of a contract, it prevents the creation of a contract.

For example: Buyer and Seller of unimproved real property believed the purchase price included a lease on the property; however, later it was determined that the lease was not binding on

the lessee. The court held that the buyer was entitled to void the contract because of mistake. If a term is stated indefinitely so that it may be interpreted in two ways, the contract becomes unenforceable on the basis that there is no mutual consent; i.e., the parties have not agreed on the same thing. If the terms give one party the right to perform or not to perform as he/she or she wishes, or are written in such a way that it cannot be clearly understood what the parties mean, the contract becomes illusory and unenforceable. For example: When a buyer agrees to obtain a loan, a mere statement that he/she will do so is not sufficient. The amount, method of payment, interest rate, type of loan, length, due date, purpose, and disposition of the proceeds must be stated.

Consideration

The consideration that makes a real estate contract binding is the mutual promise of the parties. In an agency agreement, the principal agrees to pay a commission. The agent agrees to use his/her best efforts to procure a buyer, or lessee, or a loan, or manage the property. This is called a bilateral executory contract. In a purchase agreement, the seller agrees basically to convey title and the buyer agrees to pay the purchase price. The same is true of a land contract. In a lease, the lessee promises to pay the rent and the lessor to give possession to the lessee.

Capacity

The same laws that prohibit minors, incompetents, and others from entering into binding contracts also apply to real estate contracts.

Legality

The object and consideration of a real estate contract must be legal and within public policy. If it is contrary to public policy, it is unenforceable and, in fact, is not a contract at all.

Several situations can arise in this area:

- If the law requires a license, as it does of a person operating in the field of real estate or general contracting or insurance, a contract negotiated and prepared by an unlicensed person is unlawful and, therefore, not a contract.
- Many times, parties to a contract will insert forfeiture clauses into contracts. It is a rule of law that a forfeiture clause is unenforceable, except under special circumstances such as liquidated damages.
- An interest rate on a trust deed or mortgage note in excess of the maximum rate allowed by law is unlawful as being usurious. The note, therefore, is unenforceable.
- An exclusive listing agreement prepared without a definite termination date can lead to the loss of license of the agent preparing the agreement if the licensee tries to enforce the payment of commission.
- A buyer of subdivision property entering into a contract without having been given an opportunity to read the Final Public Report of the Commissioner is not bound by the terms of the purchase contract.

These are some examples of unlawful contract situations. These, as well as others, may affect not only the validity of the contract but may constitute grounds for disciplinary action by the Commissioner against a licensee and even possible criminal prosecution by the proper authority.

Creation

A contract, generally, does not come into existence until it has been signed by the parties. A contract may arise in two ways: There may be an offer and acceptance or, after all negotiations, a final document.

Offer and Acceptance

When a buyer or seller, or a party to an exchange agreement, makes an offer to buy, sell, or exchange, no contract arises until the person to whom the offer is made accepts the exact offer, and the fact of acceptance is communicated to the person who made the offer. Only after acceptance or producing a buyer ready, willing, and able to buy, lease, or rent, does a broker earn a commission per the agreement.

Since we are dealing with a real estate transaction, for this agreement to be legally enforceable, the offer and the acceptance should be in written form. The communication of the acceptance can be accomplished either orally or in writing, according to the terms of the agreement itself or according to the practice in such circumstances in the community in which the contract is made.

The offer is, primarily, the beginning of the negotiations. The person to whom the offer is made may not find the terms of the offer acceptable and reject it. It may be rejected outright, or a counteroffer may be made. The counteroffer must, in turn, be accepted or rejected by the person making the original offer. If the parties finally agree on the same exact terms (mutual consent), they both sign the contract, and the one making the final offer is informed of the acceptance, a binding contract comes into existence.

Executory Contracts

A distinction must be made between an **executory contract** and an **executed contract**. An executed contract is one in which the provisions have been fully performed. An executory contract is one in which the provisions have not been fully performed.

A contract may be executed (carried out) within a short period of time or it may be executory for years before it is fully performed. A purchase agreement is executory until the transfer of title and payment of money, which usually takes place within 30 to 90 days. A land contract or lease, on the other hand, may take years to perform, depending on how long the buyer is given to pay the purchase price or how long the term of the lease may be. Should a broker render service or make improvements that are not in the original contract or agreed to by both parties, the costs for the improvements will be those of the broker and not the contracting parties.

The words to “execute” and “execution” of a contract must be distinguished from “executory” and “executed” contract. To execute means to sign the contract. Execution means the act of signing the contract.

Object of Contracts

The general term “real estate contracts” encompasses agency agreements, sales contracts, leases, and loan transactions.

Agency agreements: Generally, the object of an agency agreement is the appointment by a principal of a person (broker) to represent him/her or her in a specific transaction. The transaction could involve the sale or lease of property (listing agreement), management of several properties owned by one person (property management agreement), and collecting rents for the owner of a single apartment building (rental collection agreement), to name just a few.

Sales agreements: There are three of these contracts in general use: the purchase agreement (deposit receipt), the land contract, and the exchange agreement. The object of each one is the transfer of the title to a buyer; consequently, in each one, there is the promise to convey title. Presuming that the contract is a binding one, certain rights and obligations arise in the parties.

Buyer’s interest: The buyer’s interest under these contracts consists of what is called equitable title. Equitable title may be defined as the right to receive the title to the property and its possession at the time agreed upon. This right is specifically enforceable in court or, if the seller cannot convey the title as agreed, the buyer has a right to damages.

Seller’s interest: The seller retains the legal title and possession until the contract provisions call for the seller to convey title and give up possession.

Under a purchase agreement, the seller usually gives title and possession at the same time; however, possession may be given before or after the title is conveyed, depending upon the agreement. In a land contract, the seller usually gives possession at the time the contract is entered into, but the title is withheld until the purchase price has been paid, which may take years.

If the buyer breaches the terms of the contract, the seller has legal remedies. These consist of a suit for specific performance and/or liquidated damages. In the case of the seller breaching an exclusive listing by unilaterally terminating the agreement, the seller may—if the broker is allowed to continue to show the property and produces a buyer at the listed price—be forced to pay a commission, though the seller would not be forced to sell. For a party who contracts for the sale of real property to be able to sustain an action for specific performance, there must be evidence of adequate, valuable consideration.

The seller’s interest is transferable to other persons by deed or by assignment and on death goes to the seller’s heirs and devisees. A person receiving the seller’s interest is obligated to carry out the provisions of the contract.

In an exchange agreement, each party is both a buyer and a seller. Each would receive the equitable title in the property of the other party, and each would have a seller’s interest in the property they convey.

Leases: The object of the lease concerns the use of the property, not the title. The lessee (tenant) acquires the right to possession and quiet enjoyment. The lessor (landlord) gains the right to receive the agreed upon rent.

Clauses in Contracts

As stated before, the real estate licensee does not have the authority to draft an original contract. If the licensee did so, he/she or she would be guilty of the unauthorized practice of law. However, many of the contracts the licensee will be dealing with are printed forms already prepared by an attorney, with blank spaces to be filled in by the licensee. Nonetheless, the licensee should be familiar with the content of the printed clauses and their meanings, not only for the licensee's own protection, but to explain them to the contracting parties. Remember that these contracts may involve large sums of money, and if the parties do not understand what they are signing, or if the agent is careless in filling out the form, expensive litigation may result.

Many real estate firms, banks, escrow and title companies have prepared forms for their own use. Those used for state examination purposes and in our school for teaching purposes are prepared by the California Association of REALTORS® and are reproduced, with their permission, in this book.

No form, no matter how perfectly drawn or universally accepted, is good without a proper filling in of the blanks. It is the duty of the licensee to do so with accuracy, completeness, and with language free from uncertainty. The completion of the forms calls for clarity of expression, logical arrangement, proper use of technical terms, the ability to compute the necessary math in connection with financial arrangements, and the inclusion of all of the items necessary to give full information as to the nature of the transaction and the intent of the parties.

Several elements necessary to complete the various forms are of a common nature, such as names of parties, description of the property, and the method of payment. These, however, vary with each transaction, and blank spaces are left for the separate items on standard forms. Knowledge of the correct preparation of each item will apply generally to all forms.

The property description may include not only the legal description but also the nature of the interest being sold. For example: "An undivided one third interest" or a "life estate," and enumeration of the encumbrances subject to which the property is being sold. In addition, personal property being transferred may be mentioned. Any description that can be used to validly locate the property is considered adequate in a listing or purchase agreement.

The method of payment or terms may include cash, installment payments under a promissory note or agreement of sale, credit for an existing encumbrance, and miscellaneous other property, such as an existing note, vacant lot, or an automobile.

In addition, the parties often want to qualify their obligations to cover special circumstances not included in the standard forms. This is accomplished using **covenants** and conditions.

Contingencies, such as making an offer to purchase subject to the sale of another property, fall into this category. Great care must be exercised to see that the true intention of the parties is set forth so that all parties are clearly bound to perform their obligations.

Following are explanations of various clauses the agent might be required to draft. An understanding of what a certain clause is meant to accomplish will greatly assist in the agent's ability to draft it.

Acceleration: To accelerate means to go faster or "speed up." In real estate, an acceleration clause is used in an instrument calling for the payment of money, i.e., the note secured by a trust deed or a land contract. It calls for the payments to be speeded up on the occurrence of some stated event. All trust deed notes have a clause stating that the entire amount becomes immediately due and payable upon any default of the borrower. The event could be anything. If the event stated is "upon resale of the property," it may be referred to as an alienation clause or due on sale clause. However, if the event is anything else, we describe it as an acceleration clause.

Covenants: The covenants in a contract are simply the agreements between the parties. They are statements of the promises of the parties, such as that the buyer will pay money, the seller will convey title, the seller will give possession, etc. Failure to fulfill a covenant (agreement) does not release either party from their obligations under the contract. The only remedy is damages for failure to perform. For example: If possession is promised by a certain date and the seller does not give possession at that time, then the buyer may sue to secure damages but may not rescind the contract.

Contingencies: A contingency is a provision whereby one or more parties can be released from an obligation under a contract if some stated condition fails to materialize. For example: "Offer is contingent upon securing a trust deed loan for \$100,000 payable, etc.," or, "Offer subject to securing a trust deed loan for \$100,000, payable, etc.," which carries the same meaning. The contract is enforceable if the conditions are met.

A buyer's offer may be made contingent upon selling other property, upon proof of proper zoning, or some other condition. If the other property is not sold, or if the zoning is wrong, the buyer need not go through with the contract and may secure the return of his/her deposit, even though the seller has accepted the offer. Of course, if the buyer is not obligated, neither is the seller.

Subject to and **assume:** These terms determine the obligations of a seller and buyer when the buyer is purchasing a parcel of real property that is already encumbered by a trust deed or mortgage. If the buyer takes the title "subject to" a certain loan, then he/she accepts no responsibility for payment of the note; he/she merely agrees that he/she will lose the property if he/she does not make the payments. The seller remains responsible for payment. Under these conditions, the truth in lending laws would not apply because the seller remains fully responsible for the debt. If the buyer "assumes" the loan, then he/she or she agrees to pay and guarantees that the loan will be paid in full.

The only practical difference between "subject to" and "assume" is when there is a foreclosure sale and a deficiency judgment is sought. In that case, if the buyer took title subject to the loan, the buyer cannot be held responsible for such judgment; the seller is said to remain primarily responsible. On the other hand, if the buyer assumes the loan (guarantees its payment),

the buyer would have to pay the judgment, as the buyer would be primarily liable. Under an assumption agreement, the seller is not entirely relieved of responsibility, but remains secondarily liable unless specifically released by the lender.

Subordination clause: Used in a trust deed or mortgage, this clause states that some other trust deed or mortgage, dated and recorded subsequently, may take priority over it. Usually, the amount of the loan to be obtained, dated, and recorded later is stated. Such agreements are written for the benefit of the borrower.

Typical examples would be: "This trust deed is subordinate to a construction loan in the amount of \$250,000, to be obtained by trustor at a later date," or, "This trust deed is subordinate to an existing trust deed of \$100,000, payable \$800 per month, including 6% interest and any renewal or replacement of said existing trust deed."

Liquidated damages clause - This is a contractual agreement predetermining the amount of damages for breach or failure to carry out the terms of a contract. In contracts for the sale of residential property containing one-to-four units with one to be occupied by the buyer, the following provisions will apply:

The forfeiture of deposits that are paid and do not exceed 3% of the purchase price will be presumed valid unless the amount is proved to be unreasonable.

If the amount actually paid pursuant to the liquidated damages provision exceeds 3% of the purchase price, the provision is invalid and the seller will have to establish the reasonableness of the damage amount. In other sales contracts, the forfeiture of deposits actually paid will be presumed valid, regardless of the amount. Terms of a subsequent sale will be evidence of the reasonableness of a liquidated damages provision. The law also requires that such clauses be prominently displayed and separately signed or initialed by each party to the contract.

Protection clause - This clause is also referred to as the safety clause. It provides that the agent is protected in his/her commission if the property is sold after the expiration of the listing term to a person with whom the agent has negotiated during the listing term. However, before it is operative, the agent must inform the seller of the names of such persons, in writing, within the listing period. This period is often called the safety period.

Due date: The date when the total obligation on the promissory note that is secured by the trust deed, mortgage, or land contract becomes due. If the note is an installment note and is payable at so much per month, quarterly, or annually, until paid, then there is no exact due date since the note will be fully paid with the last installment. However, the balance may be due and payable after a certain number of years and would thus have a specific due date. Example: The note may be payable \$500.00 per month, including 9% interest until five years from date, when the balance of principal and interest become due and payable. It would then have a specific five-year due date.

Straight note: Must have a due date because no payments are made on it until a specified date, when the entire amount is due. Under a straight note, only the interest would be paid

during the period. For instance, the note could be made payable at the end of five years (or any other specific date) with interest payable monthly.

Consideration: All contracts must have consideration, either good or valuable. Valuable consideration may be things other than money. A contract could call for the buyer to transfer to the seller an automobile, a diamond ring, or other object. Such an object constitutes consideration. The value of such objects must be stated. For example: “\$20,000 cash and title to a certain automobile (described) valued at \$10,000.”

Assignability of Contracts: As a general rule, contracts may be assigned. Actually, the rule means that a party may assign his/her rights and not obligations. There are three exceptions:

1. A personal service contract may not be assigned, as no one may render the service called for except the person employed. Thus, an authorization to sell may not be assigned.
2. Where the terms of a contract prohibit its assignment.
3. An option may not be assigned if an unsecured promissory note is to be given for the purchase price. Under this rule, a purchase agreement, an agreement of sale, a lease, etc., being contracts concerning the sale or use of property, may be assigned.

Pest Control Documentation (Structural Pest Control Board)

Termites are the most destructive type of wood destroying insects. The subterranean type that lives in the soil and enters into the foundation of a home does more damage than the flying type known as the drywood termite.

Purchasers of property often want to be assured that the improvements are not damaged by termites or other wood destroying insects; therefore, they request a structural pest control inspection report.

Pest Control Inspection Report

Whenever a licensee is an agent in a transaction in which the delivery of a structural pest control inspection report, notice of work completed, or certification is a condition of a contract affecting the transfer of the real property or a condition of financing the transfer, the licensee shall:

- ▢ Cause delivery of the appropriate documents to the transferee.
- ▢ Determine that the transferor has caused such delivery.
- ▢ Advise the transferee that the Civil Code requires that the appropriate documents be delivered to the transferee by the transferor, owner, or the owner’s agent as soon as practical before transfer of title of any real property or the execution of a real property sales contract.

However, when a listing broker and a cooperating (selling) broker are involved in a real estate transaction, unless the transferor in the transaction has given written instructions to the listing broker to affect delivery of the documents, the responsibility is that of the broker who obtained the offer, i.e., the cooperating (selling) broker. Because the report may disclose damage to the structure, it is advisable for the owner to have the report in advance and the work completed to insure a smooth sale transaction.

The licensee shall maintain a record of the action taken by the licensee to effect compliance with this regulation in accordance with the Business and Professions Code.

Any person, whether or not a party to a real property transaction, has a right to request and, upon payment of the required fee, obtain directly from the Structural Pest Control Board in Sacramento a certified copy of all inspection reports and completion notices prepared and filed by any structural pest control operator during the preceding two years.

Forms Used in Real Estate

In this section, the printed forms will be discussed along with a link to a copy of each form.

Authorization to Sell (Listing)

A listing is a promise for a promise. It is a **bilateral** employment contract between a principal and a broker by which the principal employs the broker as his/her agent to sell, lease, exchange, or rent a property. As a rule, it is between a seller and broker; however, it could be between a buyer and broker, as when a buyer employs a broker to locate a property for sale or lease. In either case, the broker, as an agent, has a fiduciary capacity to the client. The listing broker is the only broker ethically allowed to place a sign on the property. Listings are service contracts and, as such, cannot be recorded.

As a bilateral contract, the seller and broker are bound by its terms immediately upon execution. A repudiation by the seller indicating that the seller will not perform the agreement constitutes an anticipatory breach of contract and entitles the broker to the broker's entire commission without proof of any effort to procure a purchaser.

A broker cannot exceed the authority given by the seller under a listing agreement. The right of a principal to control the activities of his/her agent is an inherent part of the law of agency.

The usual term of reference is that of the contract between the seller and the broker, commonly known as an authorization to sell. In either case, it is an employment (service) contract, and has nothing to do with the actual transfer of real property. Under this contract, the broker is created as an agent of the principal and is bound by the laws of agency, having certain obligations to the principal that do not exist between two principals. Because the listing is a service (employment) contract, it is non-assignable and is canceled by the death of either party.

The contract is strictly between the broker and the seller. It does not obligate the owner to sell the property, even though the broker brings a buyer ready, willing, and able to buy on the listed terms. In such cases, the broker has earned commission and can legally force the owner to pay it, but the owner cannot be compelled to sell until agreeing to do so by signing

an acceptance to an offer. Thus, a buyer who presents an offer on the exact terms of the listing, which the owner refuses to accept, cannot sue for specific performance (go to court to compel the owner to sell the property) since the buyer has not yet entered into a contract with the seller.

In case law, the state has asked a question that seems to differ from the principle that “any person signing a listing with a broker obligates himself/herself to pay a commission if the broker performs, even though that person cannot, or will not, deliver the property.”

This may surprise some students. If the contract calls for a forfeiture of the deposit to the seller and the seller accepts the forfeiture and releases the buyer, the broker has not, by legal authority, produced a buyer “ready, willing and able” to buy and cannot force the seller to provide any part of the forfeited deposit. On the other hand, if the seller refused the forfeiture and sued for specific performance, the broker would be due the commission because the buyer was forced to buy. In either case, the broker does not have the right to bring an action in court on behalf of his/her principal.

If only one spouse signs a listing on community property and the broker performs, that spouse has obligated the community funds to pay the commission, even though the other spouse refuses to accept the offer and the property cannot be delivered. The prudent broker will secure the signatures of both spouses when dealing with community property.

This would be true also where one party in a joint tenancy or tenancy in common signs a listing on the entire property so held. All parties to the tenancy must join in the sale, and if one refuses to do so, the property cannot be sold. A co-tenant may sell his/her interest in the property, but not the entire holding, without the consent of all parties. However, the party signing the listing may be held for the commission due the broker.

Real estate law provides that an exclusive listing must contain a date of final and complete termination. It does not specify that there must be a beginning date, and it is assumed that the date of the broker’s employment is the date the contract is signed, unless it is otherwise specified.

Real estate law also provides that when a licensee prepares or has prepared an agreement authorizing or employing such licensee to perform any of the acts that require holding a license, or when such licensee secures the signature of any person to any contract pertaining to such services or transactions, the licensee shall deliver a copy of the agreement to the person signing it at the time the signature is obtained. Provision is usually made in standard forms for an acknowledgment by the signer that the signer has received a copy.

California now requires that any printed or form agreement intended to establish a right to compensation contain this statement in not less than 10-point boldface type immediately preceding any provision of such agreement relating to compensation of the licensee.

Notice: The amount or rate of real estate commissions is not fixed by law; these figures are set by each broker individually and may be negotiable between the seller and the broker.

There are three different types of listing contracts: open listing, exclusive agency listing, and exclusive right to sell listing.

Open Listing (Procuring Cause)

An open listing is the simplest form of employment contract. Usually, it sets forth a description of the property and the price and terms of the sale. It may or may not provide a time limit for performance. The seller may give an open listing to a number of different brokers at the same time. The broker who first produces a buyer that meets the terms of the listing, or whose offer is accepted by the seller, is the one who has earned the commission. As a rule, the owner is not required to notify the other brokers of the sale in order to prevent liability for paying more than one commission. The sale itself cancels the other listings automatically. In the event that the owner finds a buyer, the owner is not obligated to pay a commission to any of the brokers holding open listings. For these reasons, brokers spend little money advertising an open listing. The only protection a broker has is to create a clause in the open listing creating a right to collect a commission if the broker notifies the owner in writing of the name(s) of prospective buyers for the property. This gives the broker proof of being the procuring cause in case of a commission dispute.



Exclusive Agency Listing

An exclusive agency listing is a contract by which a principal employs one broker as the exclusive agent to negotiate the sale of a property, and, if that broker, any other broker, or any other party who finds a buyer and effects the sale, the one holding the exclusive agency listing is entitled to the commission. It should be noted that the listing refers to an “agency.” Because the owner is not an agent, he/she or she may affect the sale without incurring liability for commission to the broker holding the exclusive agency listing.



Exclusive Right to Sell Listing

In this type of listing, the owner is obligated to pay a commission to the broker to whom the owner has given an exclusive right to sell the property, whether it is sold by that broker, any other broker, or by the owner. In other words, the owner excludes even his/her own right to sell his/her own property and must pay commission to the listing broker, no matter who generates the sale. This type of listing places a special responsibility on the broker to spend time and money to find a buyer.

An exclusive listing (agency or right to sell) must have a termination date. Such a date may be for as little as one day or for as long as may be established in the agreement. A listing cannot, for example, run for a period starting with the date of the contract and continue “until sold.” It cannot state that it is effective “until canceled in writing,” or “until a notice of cancellation is given.” It may, however, provide that the broker be protected against sale by the owner to one of the broker’s prospects for a definite period of time after the listing expires. Such a contract can be canceled, but the party so doing may be liable for damages as stated in the agreement.

Most listings state that if the seller withdraws the property from sale, the broker is entitled to a full commission. Therefore, within the four corners of the contract, there is this agreement: You have the right to cancel, but if you do, you must pay a full commission.

If the owner accepts an offer to buy under the terms of the contract and later refuses to sell, the broker may collect not only the commission due but also the damages and costs of defense against any action of the buyer to compel specific performance.

An exclusive agreement authorizing or employing a licensee to negotiate a loan secured directly or collaterally by a lien on real property shall be limited to a term of not more than 45 days.

A listing is presumed to be effective from the date it is signed unless another beginning date is mentioned in the contract.



Net Listing

A net listing may be an open, exclusive agency, or exclusive right to sell listing. It is one that permits the agent to retain, as compensation, all money received in excess of the selling price set by the seller. While the seller agrees to accept a certain set sum for the property, permitting the broker to retain any excess over that amount as compensation, real estate

law requires that the broker disclose the amount of compensation in connection with a net listing to the owner prior to or at the time when the principal binds him/her or herself to the transaction. This, of course, infers that the principal will get the owner to accept the entire contract, which includes the broker's commission.

Net listings, though they appear to give the broker an advantage of potentially receiving an excessive amount of commission, are dangerous because the owner, before accepting the contract to sell, may decide to renegotiate the commission. This could lead to a court action, which usually goes against the broker because of his/her superior knowledge and, through that knowledge, takes advantage of an innocent seller. The laws of agency and the Commissioner's Rules also come into play and could be detrimental to the broker. For example: If an offer is received at the exact selling price, affording the broker no compensation, is the broker bound to present the offer? The answer is "yes" and the broker could, under these conditions, go uncompensated. Penalty for failure to present all offers can be revocation or suspension of the license.

Multiple Listing Service

Numerous multiple listing service (MLS) organizations exist throughout California, but the trend is to combine smaller organizations to cover larger areas at less cost to the brokers and agents.

Each group provides a standard multiple listing form (usually an exclusive right to sell listing), which is used by all members. They then turn in all such listings (typically online) to a central department from which they are redistributed to all members, giving all the right to work on every listing. It is very effective in securing action for sellers and promotes business for the members.

Contracts – Broker & Principal

The contract between a broker and a principal must be specific. Although consideration is not essential to the creation of an agency, it is usually present in agreements between a real estate broker and a principal. The agency arises when the principal signs a listing contract promising compensation for service as an agent and the agent renders the service requested. This is known as a unilateral (one sided) contract, in that it imposes an express obligation on but one of many. Frequently, the broker makes a counter promise to "use due diligence in finding a purchaser," thus making it a bilateral or two sided contract.

The agency agreement between the principal and the broker may be for different matters. The broker may be appointed as an agent to sell the property, to manage the property, to rent or lease it, or to obtain a loan on it.

The Statute of Frauds requires that most of these agreements be in writing to be enforceable. In the event that a contract employing the broker is not in writing, it does not mean that it is an illegal contract but that the contract could not be enforced in a court of law. It should be noted, however, that the Statute of Frauds also provides that a verbal agreement may be enforced if there is a sufficient memorandum in writing signed by the party to be charged.

Thus, where there is a verbal listing to sell and the seller accepts an offer and signs a purchase agreement containing a clause agreeing to pay a commission, it is called a ratified agency. Usually it is sufficient to satisfy the statute.

There are four exceptions to the provisions of the Statute of Frauds. In chapter one, we established that agreements between real estate brokers to share or split a commission do not come under this law. In chapter four we pointed out that leases for periods of one year or less and listing agreements for such leases are also exempt from the requirements of this statute. Lastly, listing contracts for business opportunity transactions would also be exempt from the statute because they deal primarily with personal property matters.

When is a Broker Entitled to a Commission?

Generally, to be entitled to a commission, a broker must produce a buyer “ready, willing, and able” to purchase upon the exact terms and at the price stipulated by the principal. An “able” buyer is one financially able to obtain the necessary funds at the proper time. A “ready and willing” buyer is one willing to enter into a binding contract, as shown by an offer on his/her part.

A broker completes the performance under the contract when, within its term, the broker delivers or tenders to the owner a valid, enforceable, written offer to purchase on the terms of the sale as listed and signed by a buyer able to comply therewith, or to suffer damages if the broker fails to perform. The broker is not entitled to any commission, no matter how much time, money, and effort the broker has expended, unless a customer is produced.

When a broker has a customer that signs an offer to purchase, even though it may be on terms other than those stated in the listing, it is the broker’s duty to tender it to the seller for the seller’s acceptance or refusal. If the seller signs an acceptance of such an offer, the broker is entitled to a commission based upon the actual selling price unless terms of the contract differ.

In ordinary circumstances in real estate practice, the seller who gives a listing and agrees to pay the broker for services is called the broker’s client. The prospective buyer is referred to as the customer.

Purchase Agreement

The purpose of the purchase agreement (also called a deposit receipt) is to secure a firm offer to purchase from a prospective buyer and to give a receipt for money given by the buyer to a broker as a deposit or guarantee of the buyer’s good faith. Such deposits are sometimes called earnest money. It is a contract between the seller and the buyer. Should there be a difference in the terms of sale set forth in a listing agreement from those in a purchase agreement, the latter will prevail.

Up until the time when such an offer to purchase is accepted by the seller, it remains merely an offer and may be withdrawn (rescinded) by the buyer at any time before it is accepted and the buyer has been notified of such acceptance within the specified time.

If a seller accepts the offer exactly as made and the buyer is so notified, the purchase agreement constitutes a binding contract between buyer and seller. If the seller changes any of the terms, the seller is in effect making a counteroffer, and the original offer is dead (revoked). If the buyer rejects the counteroffer, the seller cannot reconsider and accept the buyer's original offer; the buyer would then have to make the offer again. Should both buyer and seller decide, following acceptance by both parties, to rescind the transaction, the broker should restore all monies and effect a cancellation of the agreement. This in no way affects the right of the broker to collect a commission.

If, under a listing, the broker has been given the right as an agent to accept a deposit on behalf of the seller, then, upon acceptance of the offer, that deposit belongs to the seller. In any event, the deposit never belongs to the broker. Therefore, the broker may not commingle it with the broker's own funds. The form should contain a complete understanding between buyer, seller, and broker as to the return of the deposit if the offer is not accepted, as well as provisions for forfeiture and disposition of deposit money should the purchaser fail to complete the purchase. Provisions of this nature are usually included in the printed clauses in a standard form, but if other agreements are necessary, it is important that they be set forth with care.

It is also most important that all terms and conditions, including arrangements for financing, be clearly expressed, with a statement by the buyer that the buyer will deposit the proceeds of a loan being secured by the buyer to consummate the sale. It is the broker's obligation to use the utmost care in the preparation of the form.

Should the buyer or seller wish to contract for items not printed on the form or wish to change the wording of the printed matter, the handwritten entries would take precedence over any printed matter as evidence of the latest meeting of the minds of the parties.

The broker's obligation also includes honesty toward both buyer and seller. There can be no willful concealment or suppression of facts. The broker may not withhold from the buyer material facts regarding the property about which the broker is informed but which are not known or visible to the purchaser.

Either spouse may buy real property with community funds without the other's consent; therefore, the signature of either spouse is binding on an offer to purchase. However, the actual sale of community real property requires the signatures of both spouses on the purchase agreement.

As with all contracts requiring signatures of the parties that a real estate licensee negotiates and prepares, a copy of the contract must be given to the person signing it at the time the signature is obtained. Therefore, a sufficient number of copies should be made so that one may be given to the prospective buyer at the time of the offer, another given to the seller at the time the seller signs the acceptance, and a third copy with both signatures on it retained by the broker for the broker's files. It is good practice to make yet another copy of the offer, have it signed by the seller upon acceptance, and present this to the buyer, even though the buyer already has a copy of the signed offer.

If a seller misrepresents necessary facts and, under the terms of a listing, the broker produces a buyer ready, willing, and able to buy who, after all papers are signed, refuses to buy because of the misrepresented facts:

1. The buyer has the right to do so, and
2. The broker would be due a full commission.

Under the Statute of Frauds, a broker may not resort to court action to enforce collection of a commission from a seller unless the broker has a signed authorization to sell or some other written memorandum agreeing to pay the broker a commission. Sometimes, a broker will work on a property on which the broker has no listing but is able to secure an offer that is accepted by the seller. In this event, the broker must get a separate agreement as to commission, such as a listing.

Matters of title, taxes, insurance premiums, rents, bonds, possession, and time limit for acceptance are usually taken care of in the printed clauses of standard forms. These clauses need to be read and studied, because they bind the parties in many ways and are of great importance to the buyer and seller in an actual transaction. The clients depend upon you, their real estate agent, to prepare the terms of their agreement properly.



Uniform Vendor and Purchaser Risk Act

It sometimes happens that, after a contract is made for the purchase and sale of real property, a fire or other disaster destroys or seriously damages the property. Who shall take the loss? In 1947, California adopted the Uniform Vendor and Purchaser Risk Act, which provides a statutory answer. Under it, any contract made in this state for the purchase and sale of real property shall be interpreted as including an agreement that the parties shall have the following rights and duties, unless the contract expressly provides otherwise:

If, when neither the legal title nor the possession of the subject matter of the contract has been transferred, all or a material part thereof is destroyed without fault of the purchaser or is taken by eminent domain, the seller cannot enforce the contract and the purchaser is entitled to recover any of the portion of the price he/she has paid, including his/her deposit.

If, when either the legal title or the possession of the subject matter of contract has been transferred, all or any part thereof is destroyed without fault of the seller or is taken by eminent domain, the purchaser is not thereby relieved from a duty to pay the price, nor is he/she entitled to recover any portion thereof that he/she has paid.

Chapter 10 Summary

Valid: having force or binding force, legally sufficient and authorized by law, i.e., enforceable.

Void: having no force or effect, i.e., that which is unenforceable.

Voidable: capable of being adjudged void but is not void unless action is taken to make it so.

Duress is unlawful constraint exercised upon a person whereby he/she or she is forced to do some act against his/her will, creating a voidable contract.

The **Statute of Frauds** is a law requiring certain contracts to be in writing and signed before they are enforceable in a court of law. Almost all the contracts with which a licensee in the field of real estate is involved come under this law and must be in writing or they cannot be enforced in a court of law. This includes most listing agreements.

Consideration is required to make a real estate contract binding. It is the mutual promise of the parties. In an agency agreement, the principal agrees to pay a commission. The agent agrees to perform a service. Valuable consideration may be things other than money.

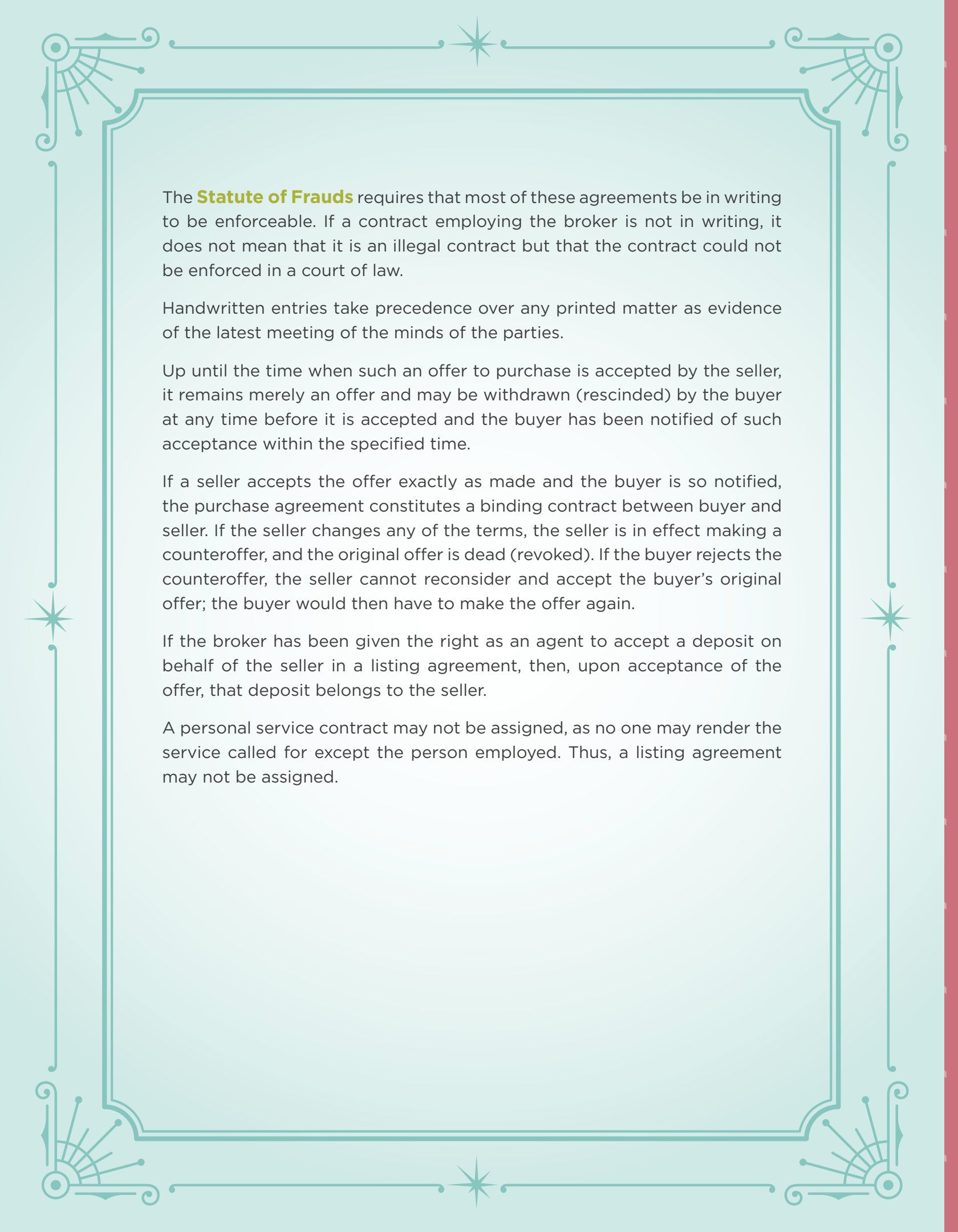
A **Subordination Clause** used in a first or senior lien allows it to be subordinated to a subsequent lien, such as a construction loan. It converts a senior trust deed into a junior trust deed (second, third, etc.).

A **Protection clause** or safety clause provides that the agent is protected in his/her commission if the property is sold after the expiration of the listing term to a person with whom the agent has negotiated during the listing term provided notice in writing is given.

Termites are the most destructive type of wood destroying insects. The subterranean type that lives in the soil and enters the foundation of a home does more damage than the flying type known as the drywood termite.

There are three different types of listing contracts: open listing, exclusive agency listing, and exclusive right to sell listing.

Notice: The amount or rate of real estate commissions is not fixed by law; these figures are set by each broker individually and may be negotiable between the seller and the broker.



The **Statute of Frauds** requires that most of these agreements be in writing to be enforceable. If a contract employing the broker is not in writing, it does not mean that it is an illegal contract but that the contract could not be enforced in a court of law.

Handwritten entries take precedence over any printed matter as evidence of the latest meeting of the minds of the parties.

Up until the time when such an offer to purchase is accepted by the seller, it remains merely an offer and may be withdrawn (rescinded) by the buyer at any time before it is accepted and the buyer has been notified of such acceptance within the specified time.

If a seller accepts the offer exactly as made and the buyer is so notified, the purchase agreement constitutes a binding contract between buyer and seller. If the seller changes any of the terms, the seller is in effect making a counteroffer, and the original offer is dead (revoked). If the buyer rejects the counteroffer, the seller cannot reconsider and accept the buyer's original offer; the buyer would then have to make the offer again.

If the broker has been given the right as an agent to accept a deposit on behalf of the seller in a listing agreement, then, upon acceptance of the offer, that deposit belongs to the seller.

A personal service contract may not be assigned, as no one may render the service called for except the person employed. Thus, a listing agreement may not be assigned.

chapter 10 quiz

1. Which of the following best defines a contract:

- a. Two or more persons entering into a legal agreement.
- b. Two or more competent persons entering into a legal agreement to do a legal act.
- c. Two or more competent persons entering into a legal agreement for a consideration to do or not to do a certain thing.
- d. Two or more competent persons entering into an agreement to do or not to do a certain thing.

2. All of the following are necessary elements of a contract except:

- a. Must have a legal object.
- b. Competency of the parties.
- c. Payment of money.
- d. Meeting of the minds.

3. A contract is signed by a party who, through fraud of the other party, is deceived as to the nature of the contents of the document itself. Contract is:

- a. Valid.
- b. Voidable.
- c. Void.
- d. None of the above.

4. A voidable contract is:

- a. One executed on a Sunday.
- b. Valid unless and until action is taken to disaffirm.
- c. Binding on the injured party.
- d. Unenforceable.

5. A contract signed under duress is:

- a. Valid.
- b. Void.
- c. Voidable.
- d. Unenforceable.

6. As used in real estate practice, a rider:

- a. Is an amendment.
- b. Is a person.
- c. Is a lien.
- d. Is a contract.

7. The parties enter into a contract with mutual assent as to the subject matter of the agreement, but there is a mistake as to a basic or material fact that induces one or both of the parties to enter into the contract. The contract is:

- a. Valid.
- b. Voidable.
- c. Void.
- d. None of the above.

8. If a seller wanted to relieve himself/herself of the primary liability for payment of a trust deed and note, he/she must find a buyer who is willing to:

- a. Assume the trust deed and note liability.
- b. Sign a release agreement.
- c. Take title subject to the trust deed and note.
- d. Execute a subordination agreement.

9. A clause in a trust deed providing that the rights of the beneficiary are secondary to those of holders of subsequently recorded trust deeds is known as:

- a. Acceleration.
- b. Alienation.
- c. Subrogation.
- d. Subordination.

10. The word "subordinate" is most opposite in meaning to the word:

- a. Superior.
- b. Inferior.
- c. Subrogation.
- d. Deference.



“There is something permanent,
and something extremely
profound, in owning a home.”

- Kenny Guinn

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Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 1. Il presente contratto ha per oggetto la vendita di un immobile sito in Torino, nella circoscrizione di [Indirizzo], con una superficie di [Superficie] mq. L'immobile è stato acquistato dal venditore a titolo definitivo e libero da ogni gravame. Il venditore garantisce che l'immobile è libero da ogni ipoteca, privilegio, usufrutto, enfiteusi, servitù, diritti di usufrutto, uso, abitazione, ecc. Il venditore garantisce inoltre che l'immobile è libero da ogni altro diritto di terzi. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 2. Il prezzo di vendita dell'immobile è di Euro [Prezzo]. Il prezzo è pagato in contanti e viene versato al venditore in un'unica soluzione alla data di sottoscrizione del presente contratto. Il venditore rilascia al Cliente un quieto titolo di vendita dell'immobile.

Art. 3. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 4. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 5. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 6. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 7. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 8. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 9. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

Art. 10. Il presente contratto è stato redatto in triplice copia. Una copia sarà consegnata al Cliente, una al venditore e una al notaio. Il presente contratto è valido e ha efficacia a partire dalla data di sottoscrizione.

CHAPTER 11:

contracts – part two

Learning Objectives

Continuing our review of contracts from chapter 10, this chapter covers different types of purchase contracts including exchange agreements. Many purchase agreements are now also escrow instructions. The process of escrow is explained with an explanation of Escrow Law and examples of escrow closing documents.

key terms

AITD	Double Escrow	Interpleader Action
Banking Year	Dual Agent	Land Contract
CalVet	Escrow Holder	Option
Closing Costs	Escrow Law	Optionee
Closing Date	Exchange Agreement	Optionor
Credit	Fiscal Year	Principals
Debit		Recurring Costs

Real Property Sales Contract

A real property sales contract is a written statement in which a seller agrees to convey title to real property to a buyer after the buyer has met certain conditions specified in the agreement and which does not call for the conveyance of title within one year of the execution of the contract. If the condition to be satisfied by the buyer is the payment of the purchase price, a **land contract** may be defined as a real property sales contract which provides that the seller (vendor) will act as the lender (by extending credit) and that he/she will hold the title to the property as security for the payment of the debt (the balance of the purchase price.) The purchaser holds possession and equitable title. There are no implied warranties in a land contract. Such an agreement is unenforceable unless it is in writing and signed by the party against whom enforcement is sought (seller) or by that party's agent.

This device is also known as:

- ▢ Installment sales contract
- ▢ Land sales contract
- ▢ Land contract of sale
- ▢ Agreement to convey
- ▢ Conditional sales contract
- ▢ Agreement for purchase and sale
- ▢ Land contract

Real property sales contracts most often are used when the buyer does not have sufficient cash for a substantial down payment on the property. It is a security device in that the owner retains title to the property to insure the payment of the price. He/she may require that the buyer pay the amount in full before he/she will deliver a deed to the property (as is done in **CalVet** financing) or he/she may agree to give a deed when the buyer has paid in a sufficient amount to make the owner feel secure in giving title to the property, at which time (according to agreement) the buyer signs a note and trust deed for the balance as in a regular sale.

The title to the property being sold under a real property sales contract need not be free and clear of money encumbrances at that time, but it is the obligation of the seller to clear off such encumbrances before the time that he/she is required to deliver the title, unless otherwise agreed upon.

Since the seller holds the legal title there is no guarantee clear marketable title will exist upon completion of the contract. The buyer or vendee, as he/she is referred to, only holds equitable title, which is why the contract is not considered a secure collateral by institutional lenders.

Since the existing contract does not prohibit a sale or assignment, the vendee may sell the property by assigning his/her interest in the contract or sell his/her interest using another land contract between himself/herself and the new purchaser. However, he/she is still personally obligated on his/her original contract unless he/she obtains a release of liability from the original vendor.

When the contract of sale is signed, and the seller owes an outstanding obligation, the buyer's contract payments must be used to meet the seller's payments. It is also necessary that, should the buyer make impound payments for taxes, insurance, etc. to the seller, these moneys must be held in trust and used for no other purpose unless the seller receives the buyer's written consent to do so. Every seller of property under a real property sales contract who appropriates the payment for other than payment of the seller's obligation is guilty of public offense punishable by a fine of not exceeding \$10,000 or by imprisonment in the state prison, or in the county jail not exceeding one year, or by both such fine and imprisonment. In the event the seller transfers the title to another, he/she also must assign his/her interest in the land contract to that person and, if he/she assigns his/her contract to another, he/she also must transfer the title to the assignee.

Sometimes a land contract will contain a provision prohibiting the buyer from recording the contract. The courts have held that such a provision is not enforceable. The buyer should be entitled to record his/her contract for his/her own protection in the event seller should again contract to sell or take steps to mortgage the property. However, the seller's signature must be acknowledged by him/her to make the contract eligible for recording. When recorded, the land contract becomes a cloud on the title to the property. This protects the title to property which is unoccupied by the buyer.

When selling a parcel of land under a real property sales contract which is not recorded, the seller is prohibited from otherwise encumbering the parcel to an aggregate amount exceeding the amount due under the contract without the written consent of the purchasing party. In addition, if after entering into the contract of sale the seller should seek additional financing on the property, such encumbrances may not exceed the amount of the buyer's contract payments without the buyer's written consent. In addition, the seller must transfer the title to the property which is the subject of the contract together with the contract and must assign the contract if he/she transfers the real property which is the subject of the contract.

Real property sales contracts must recite the number of years required to complete payment in accordance with the term of the contract and, if a tax estimate is made, the basis for it.

The law requires that each sales contract relating to purchase of real property in a subdivision shall clearly set forth the legal description of the property. All of the existing encumbrances on the date of the contract and terms of the encumbrances must be set forth. Other than in a subdivision, contracts of sale are not held to the same degree of certainty in description as are deeds. Courts have allowed oral evidence to be admitted completing a description in a contract of sale.

A buyer shall be entitled to prepay all or any part of the balance due on any real property sales contract with respect to the sale of land which has been subdivided for not more than four families provided the seller, by an agreement in writing with the buyer, may prohibit prepayment for up to a 12-month period following the sale (locked in clause). Any waiver by the buyer of the provisions of this section shall be deemed contrary to public policy and shall be unenforceable and void, provided, however, that any such waiver shall in no way affect the validity of the remainder of the contract.

One of the rights available to the vendor on a contract of sale is the right of rescission. In the event of default of payments on the contract, and exercise this right, the vendor would inform the buyer of his/her intention to rescind and return everything of value he/she had received to the buyer on the condition that the buyer does the same. To affect a rescission of the contract, the purchaser must agree and is normally entitled to a refund of payments made under the contract.

Should a recession of contract be rejected by the buyer who is behind in payments, the buyer's position in a land contract is better defensively than in any other security device. According to the court decision in *Barkus vs. Scott*, the rule against forfeitures was sufficient barrier to harsh and unreasonable foreclosure proceedings

In a qualified installment sale, the taxability of the gain recognized on the sale is deferred until the actual receipt of the purchase price.

The broker is entitled to, or has earned his/her compensation, when the sales contract has been signed by the parties unless otherwise defined in the contract.

Exchange Agreement

The **exchange agreement** is in the form of an offer and acceptance agreement, as is the purchase agreement. An offer to exchange is made by one party and the exact offer must be accepted by the other party before a binding contract can arise. The same reference about a counteroffer in the purchase agreement also applies to the exchange agreement.

The printed clauses of the agreement contain the consent of both parties to the broker(s) commission, as well as providing for all other terms, prorations, etc.

There are several good reasons for suggesting to a client that a trade may be advantageous and sometimes, as when there is a tight money market and financing is not readily available, it may be the only way of disposing of a property. If the equities of the owners are of the same approximate value, little cash outlay is required. The properties themselves constitute payment of the purchase price usually with no financing necessary. Because of increasing tax burdens, many exchanges are secured from persons in high tax brackets who own depreciated property. They desire to exchange for a property with a higher cost basis in order to provide a higher annual depreciation tax shelter. Of course, if agents are involved, commissions will also be due.

The use of a trade or an exchange of properties is, in a sense, an alternative form of financing. It might be argued, however, that it really isn't so, since most of the properties involved in exchanges are financed. However, many times exchanges are made without use of additional financing or cash. One party may also offer to exchange his/her equity for that of another without any additional cash, even though his/her equity may be a lesser sum. Other good reasons to employ an exchange would be the possible deferment of payment of capital gains tax and the convenience of not having to wait until one property is sold to secure cash to purchase a larger holding.

Actually, in a trade, the owners exchange the equity in their respective holdings, each taking over the encumbrances existing on the newly acquired property. For example, the owner of a property with a fair market value of \$535,000, which is subject to a first trust deed lien of \$508,000, exchanges it for a property having fair market value of \$655,000 and which is encumbered with a first trust deed lien of \$622,000. The owner of the first property offers the equity of \$27,000 in his/her property ($\$535,000 - \$508,000$) together with a \$6,000 cash payment to satisfy the equity of \$33,000 ($\$655,000 - \$622,000$) of the owner of the second property. Each party agrees to take over the loan obligation on the property which they acquire. In these circumstances there could be a workable exchange of properties assuming everything else is agreeable to the two parties.

Under current federal and state tax laws, the exchange of property for like-kinds of property is permitted without the parties paying taxes on the profit (capital gain). The payment of the tax on the gain is deferred to a later time. Such an exchange is referred to as an IRS Section 1031 exchange.

You also should pay attention to the fact that in the above example the party who receives the \$6,000 cash payment (boot) might be subject to paying income tax on that amount. In the example, if the \$6,000 cash received by the owner of the \$655,000 property represents a capital gain it must be reported as taxable income by the recipient. You should also be alert to the fact that, in general, exchanges of real properties can be arranged in such a way as to be completely tax deferrable for all the parties involved, or they can be partially taxable for one or other or all of the taxpayers who are parties to such an exchange. The amount of tax, if applicable, may differ based upon the state and federal tax laws.

Options

An **option** to buy is a contract by which an owner, in exchange for an actual consideration, gives another person the right to buy, and agrees to sell, a property within a certain time for a specified price and upon specified terms. The optionee obtains no legal interest in the property, only a right to buy.

The practical effect of an owner giving an option is to keep the offer to sell open. Should, during the period of the option, the value of the property increase that increased value would go to the optionee. Effectively, this appears to indicate that the property is off the market but that is not necessarily the case. The owner (optionor) could sell the property to another, subject to the option. It is rare that such would ever happen, but it could take place. Since the option is still in effect the purchaser, in effect, acquires title to the property subject to the right of the optionee to purchase.

The optionor must sell to the optionee at the price and terms agreed upon if the optionee elects to buy within the time limit of the option contract. If the optionee elects not to complete the purchase he/she simply forfeits the consideration paid for the option. The optionor and optionee would be relieved of any further responsibility in the matter.

The holder of an option (**optionee**) may, during the option period, secure another purchaser, at a higher price and, after exercising the option himself/herself, transfer the property to the new buyer, without disclosing to the optionor the price he/she received. This is true unless the optionee is licensed by the Department of Real Estate when provisions of the Real Estate Law will be in effect where full disclosure is mandated.

An optionee may sell his/her option to a third party and assign all of his/her rights and interest therein, without consent of the optionor, except when unsecured promissory notes are to be given as a part of the consideration for the purchase of the property. The law provides this protection to the optionor because he/she is dealing with the optionee and not with a third party and he/she relies upon the financial responsibility of the optionee rather than on that of the third party.

Conversely, an optionor may sell the property subject to the rights of the optionee.

When an optionee decides to buy the property (exercise his/her option), the option becomes a sales contract and both optionor and optionee are legally bound by its terms. It is important, therefore, that the option set out the details of the proposed purchase. If it merely states the total sales price, the optionee cannot insist upon terms.

The proposed buyer (optionee) must notify the optionor of his/her election to buy the property within the time limit established in the option.

The consideration given for an option may be money or anything of value but it must be actual, that is, it must in fact pass from the optionee to the optionor, even though it may be only one dollar on a \$100,000 property. A mere recital of the consideration is not sufficient.

One does not need to be licensed in real estate to take an option on real property and sell, either the option itself or the property at a profit, without disclosing the amount of profit to the original seller. Both optionor and optionee are **principals** (seller and buyer).

The Department of Real Estate does not have any jurisdiction over the use of options, except in the case of a broker who takes a listing together with an option to purchase. Here the broker is first of all an agent under the listing agreement and the responsibility of full disclosure is not eliminated by also becoming an optionee. In this dual capacity, the broker must secure the optionor's written consent to exercise the option as set forth in the Real Estate Law.

A broker, under a listing, is not entitled to a commission for having secured a customer who takes an option on the property. His/her right to a commission does not occur until the customer exercises the option and purchases the property.

If an optionee records his/her option and then does not buy the property the optionor should, in the terms of the option agreement, require the optionee to remove it from the records by recording a release or a quitclaim deed.

In some circumstances lease agreements contain an option for the lessee to purchase the leased property within a specified period of time. Such an option is a covenant running with the land and in the absence of restrictive provisions in the lease, an assignment of the lease includes the option. This kind of option normally does not run beyond the term of the lease.

Escrows

The **Escrow Law**, as part of the Financial Code, establishes the criteria under which escrow officers must act. The owner of an escrow company is required to post a bond with, and act under the Commissioner of Corporations. The license law makes exceptions in connection with certain groups, such as:

- Any person doing business under any law of this state or the United States relating to banks, trust companies, building and loan, savings banks or insurance companies.
- Any person licensed to practice law in California who is not actively engaged in conducting an escrow agency.
- Any person whose principal business is that of preparing abstracts or making searches of title that are used as a basis for the issuance of a policy of title insurance by a company doing business under any law of this State relating to insurance companies.
- Any person licensed as a broker by the Real Estate Commissioner while performing acts in the course of or incidental to his/her real estate business.

In making certain exceptions to the persons subject to the Escrow Law, the legislature considered the fact that they were under the supervision of some state agency. Because real estate brokers are licensed by the Department of Real Estate, it was felt, no doubt, that their actions were controlled in handling their own escrows, therefore, they were not required to have the special escrow license for this purpose.

The commissioner points out that any complaint against real estate brokers who handle their own escrows will be vigorously investigated and that he/she will expect those brokers to make their records, in connection with escrow services, available at the request of his/her deputies. Any dishonest practices could be made the basis for a formal administrative hearing.

The handling of all papers and funds in connection with real estate transactions is complex and needs someone skilled in this work to perform the matters promptly and accurately. For this reason, the custom has grown in California of entrusting these details to a disinterested third party, authorized to act as the agent of both parties to the escrow. Such third party is known as an **escrow holder**. While documents, funds, and instructions relating to real estate transactions are in the hands of the third party, they are said to be **in escrow**.

Should any conflict occur with respect to any document in an escrow, it is the duty of the escrow officer to notify all parties to the escrow of such a conflict and gain agreement as to the resolution of differences. The real estate broker who opened escrow should be certain that the purchase agreement terms were translated exactly into the escrow instructions. The broker should also be notified of any conflicts in order to gain agreement of the parties. The broker, however, cannot act unilaterally and cancel the escrow without agreement of all parties.

An escrow has become an almost indispensable mechanism in the consummation of a multitude of real estate and other transactions such as leases, sales of personal property, sales of securities, negotiations of loans, sales or exchanges of real property, etc. The Civil Code defines an escrow as follows: "A grant may be deposited by the grantor with a third person to be delivered on the performance of a condition and, on delivery by the depository, it will take effect. While in the possession of the third person and subject to conditions, it is called an escrow."

An escrow agent is the depository, agent, trustee, or third person, having and holding possession of money, written instruments, or personal property to be held until the happening of a designated condition, and when these conditions are met and performed, the escrow agent is generally released from liability.

The average escrow company takes care of the preparation of all papers involved in a real estate transfer. This includes getting the paperwork properly signed, delivered, recorded, and then accounting for all funds involved. A fee is charged for this service.

An individual may not be licensed as an escrow holder. The license must be held by a corporation duly organized for the purpose of conducting an escrow business.

Licensed escrow agents are prohibited by law from paying referral fees to anyone unless they are a regular employee of the company. This includes giving commissions to real estate brokers and others for sending business to a particular escrow company. Such fees include gifts of merchandise or other things of value.

A real estate broker should have both buyer and seller signed to a sales contract which sets forth all conditions of the sale before going to escrow. Remember, an escrow clerk is not a closer. The details of your transaction should be worked out completely before going to escrow.

The term **double escrow** is used when two transfers involving the same property are in progress simultaneously. Usually, there is a middleman involved who makes a profit. Brokers are cautioned regarding disclosures in this type of escrow.

Escrow instructions are not a contract. They are merely instructions to a third disinterested party to carry out certain acts. Though not a contract within itself, the instructions will supersede the purchase agreement as a meeting of the minds of the parties because they are signed at a later date. When the instructions have been signed by the parties to the escrow, neither party may change escrow instructions to the detriment of the other. However, by mutual agreement between both parties to the escrow, the instructions may be changed at any time and one party may waive the performance of certain conditions, if in doing so the waiver does not act as a detriment to the other parties to the transaction.

Customarily, an escrow agent is held liable if he/she violates the instructions of the parties to the escrow. It has been held that all the performance required by escrow instructions must be performed within the time limit set forth in the escrow agreement and the escrow agent has no authority to enforce or accept the performance after the time limit provided in the instructions.

When no time limit is set forth in a purchase agreement the escrow officer will assume a “reasonable time.” Such a time will be no less than 30 days and no more than the time it takes to clear title and be ready to record. When the time limit provided in the escrow agreement has expired and neither party to the escrow has performed in accordance with the terms of that agreement, good sense dictates that all the parties are entitled to a return of their respective documents and funds (if any) by the escrow holder. Another answer, if the parties refuse to have the escrow close in this fashion is to have the escrow holder file an action in court called **interpleader**. The court will determine the rights of the parties. Of course, an escrow instruction, like any other contract, can be dissolved by mutual consent of all parties.

Requirements for Escrow

To open:

- ▢ Binding contract (for real estate it must be in writing) between parties.
- ▢ Conditions to be satisfied.
- ▢ Submit contract to neutral third person (escrow holder).

During this period, the third person (escrow holder) is the **dual agent** (trustee) of the parties to the contract but is not the agent of the broker. The escrow holder owes a fiduciary duty to both parties in an escrow (usually the buyer and seller). The escrow holder does not hold a fiduciary relationship to the broker involved. Therefore, the broker would have no power to change any of the agreements in an escrow unless both the buyer and the seller give the broker the authority to do so.

To close escrow, all conditions must have been satisfied and all moneys deposited.

The escrow holder acts independently as an agent for:

- The buyer: to deliver the deed and other documents.
- The seller: to deliver the consideration from buyer.

Escrow reports the selling price to the IRS. The IRS requires that the selling price of real property be reported to them. The primary responsibility for this report is the escrow officer.

Closing Statements

When a real property sale closes, certain costs arise that must be paid. These expenses, which are incidental to completing the transfer of title, and which are incurred by both the seller and the buyer, are usually referred to as **closing costs**.

Customs have developed in most California counties on whether seller or buyer is charged with certain closing costs or whether these costs are divided between them. However, these customs are not hard and fast rules and the parties are free to negotiate who will pay for which item.

Some charges are the direct liability of one party because of contractual agreements with a third party, such as the seller's duty to pay his/her brokers commission as agreed to in the listing agreement. The obligation of one party to pay those charges is seldom shifted to the other party by their agreement of sale or the escrow instructions. The following chart lists common closing costs and indicates who typically pays the charge.

Note: The final amount on each side of a closing statement is forced into balance by a differential to be paid in cash by either the buyer or the seller. Rarely is the balance equal without the forced addition.

Examples of Closing Costs	Buyer Pays	Seller Pays
Real Estate Broker's Sales Commission		X
Items Connected With New Financing:		
Loan Origination Fee (Points)	X	
Loan Discount Fee (Points VA)		X
Loan Appraisal Fee	X	
Credit Report Fee	X	
Tax Service Fee	X	
Hazard Insurance Premium	X	
Expenses Connected With Seller's Loan:		
Repayment Loan Fee		X
Reconveyance Fee		X
Assumption Fee	X	
Title Charges:		
Escrow Settlement Fee (Generally)	1/2	1/2
CLTA Title Insurance Premium (Generally)		X
ALTA Title Insurance Premium (Generally)	X	
Other Charges:		
Notary Fee on Grant Deed		X
Notary Fee on New Deed of Trust	X	
Recording Fee	X	
Documentary Transfer Tax		X
Pest Inspection Report		X
Pest Control Work (Corrective Work)		X

Basic Rules

Some general rules may be drawn regarding "third party items." Whoever signs a document will pay the charge for acknowledging and drafting. Whoever receives the document will pay for recording the document, except when an institutional lender is involved.

Recurring costs: Costs that occur more than once on the property such as tax impounds.

One time escrow costs include:

- Appraisal fee
- Broker's commission
- Title insurance premium
- Escrow fees
- Recording fees
- Documentary transfer tax.

Proration Items

These are the items which will be paid by the buyer to the seller, or by the seller to the buyer, in order to prorate or distribute the charges between them. These items are: interest, insurance, rents, security deposits, taxes and trust accounts on existing loans. A proration is a proportional adjustment of some fee or other charge which occurs in the purchase of real estate. The adjustment is ordinarily between the seller and the buyer in that escrow divides the charge in relation to the date that ownership changes hands.

Closing statements are made up in **debit** and **credit** form. If an item is owed by the seller, it is **debited** (charged) to him/her; if it is owed to the seller, it is **credited**. On the other hand, if the item owed by the buyer, it is debited to him/her. If it is paid to the buyer, the buyer is credited.

Most of the prorated items are owed by the seller to the buyer or by the buyer to the seller and will therefore appear on both the buyer's and seller's statements. When a prorated item appears on both statements, it will, with one exception, be debited to one and credited to the other.

Interest: As a rule, interest is always paid in arrears and the seller will always owe interest on any existing encumbrance and will, therefore, be debited for it. In the event the buyer is taking over the existing loan, the amount of interest owed by the seller to the closing date of escrow will be credited to the buyer, as he/she is the one who will have to make the next payment on the loan, including past interest.

Insurance: As a general rule, fire insurance premiums are paid in advance of the period of the coverage. In the event an existing policy is terminated because the buyer is obtaining his/her own new policy, there will be a short rate credit to the seller for the canceled policy. Should the buyer obtain new coverage, the charge for the new policy will be debited his/her account. Should the buyer take over the existing seller's policy, there will be a credit prorated to the seller and an equal debit to the buyer, as the buyer will owe the seller for the time remaining on the policy he/she is assuming.

Rents: When income producing property is involved, there will be rents to prorate. Rent is usually paid in advance and the buyer is entitled to the rent after the close of escrow. That rent is in the possession of the seller and must be turned over to the buyer. This payment to the buyer is accomplished by debiting the seller and crediting the buyer. The amount usually is a part of one month's rent; however, in the event the last month's rent on the lease has been paid to the seller, the amount debited and credited will be the last month's rent plus the proration of the current month.

Security deposits and prepaid rents: In the event all or a portion of the property is leased and the seller is in possession of a security deposit from the lessee, the amount of the deposit must be turned over to the buyer for the reason that the security deposit is only held in trust and must be returned to the lessee at the termination of the lease. It is accomplished by debiting the seller and crediting the buyer. This is also true of any prepaid rents.

Property taxes: With the exception of a transaction closing on July 1st, the amount of real property taxes will always have to be prorated. Taxes may be in arrears, or they may be paid in advance. If they are in arrears, the seller will be debited and the buyer credited; if paid in advance, the seller will be credited and the buyer debited. In determining the tax proration, it may be said that if the taxes are paid up at the date of close of escrow the seller will be credited and the buyer debited; if they are not paid up at the close of escrow, the seller will be debited and the buyer credited.

Trust accounts (Impound accounts): A trust account is an accumulated amount of money the borrower has placed on deposit with the lending institution for the purpose of paying taxes and insurance. Since in a closing statement the taxes and insurance are prorated directly, the balance in the trust account is treated as a separate item. In all cases the seller will be credited with the remaining amount in the trust account. The buyer will be debited with the same amount if the buyer is taking over the existing loan. If the buyer is obtaining his/her own financing, then he/she will not be debited with the trust fund but will probably be debited with an amount of impounds.

Impounds: An amount of money placed on deposit with the lender on a new loan and remitted periodically thereafter for the payment of future taxes and insurance. Once on deposit, they become the trust account. The lender may call this an escrow account.

Rules Summary

Certain rules may be drawn from the above discussion:

Interest: Always paid in arrears. Debit seller, credit buyer, if taking over an existing loan.

Insurance: Always paid in advance. Credit seller, debit buyer, if taking over the existing policy. Short rate the policy and credit seller if canceled. Note: Short rate forces the seller to pay a high premium to cancel the policy prior to its maturity. Insurance companies do this in an attempt to cover their costs and induce the buyer to take over the remaining policy. The insurance company uses the short rate in an attempt to make the policy difficult to pay off. The insurance company wants to keep policies in force and will allow an assignment but only under the circumstances that both parties agree in writing to do so. During ownership, cancellation can occur only after a certain number of days specified in the policy related to notice of cancellation.

Rents: Usually paid in advance to seller. Debit seller, credit buyer.

Security deposits: Always paid in advance. Debit seller, credit buyer.

Taxes: May or may not be paid in advance. If paid in advance at the close of escrow, credit seller and debit buyer. If not paid in advance at the close of escrow, debit seller and credit buyer.

Trust accounts: If on deposit always credit seller. If buyer is taking over existing loan, debit buyer.

Property Tax Prorations

Real property taxes may be paid in two installments. Taxes are assessed on a **fiscal year** basis, the period running from July 1st to June 30th of the following year. The bill for the entire period is delivered by November 1st, but this is separated into two amounts for the convenience of the taxpayer. The first installment is due November 1st and delinquent after December 10th; the second, covering the period from January 1st to June 30th is due February 1st and delinquent after April 10th.

Taxes usually are prorated in the closing of most real estate transactions. The proration is figured from the beginning of the fiscal year (July 1st) to the closing date of escrow. If they have been paid in full, the buyer will be charged with the portion not used by the seller, and the seller credited with this amount. If they have not been paid in advance and the seller has used up any portion of the taxable period, he/she will be charged with his/her share and the buyer credited

To prorate taxes, find the amount per month by dividing the annual tax amount by 12 months (figure to four places.) To find one day's taxes, divide the monthly figure by 30 days, regardless of the month in question (answer to four decimal places.) Escrow companies use a 30 day month and tables based on the recording date of documents.

Note: All escrow prorations are based on a 30-day month or on a 360-day year. This kind of standard is referred to as a **banking year** in common practice.

Proration problems in state examinations refer to a **closing date**, or "escrow to close on," or "escrow closed." In any event, divide the month proportionately with the closing day charged to the seller, except when it closes on the first of the month. To illustrate:

1. If the closing date is the 10th, charge or credit (as the case may be) $\frac{1}{3}$ of the monthly figure.
2. If the date is the 15th, use $\frac{1}{2}$ of a month.
3. If the date is the 20th, use $\frac{2}{3}$ of a month.
4. If the date is the 1st, charge the buyer with a full month.

Prorations Worksheet

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If the item is paid to a date: Short of Escrow - Debit Seller
If the item is paid to a date: Beyond Escrow - Debit Buyer

Calculations

.....

There are two steps...(in this order):

- 1.) Determine **WHO** owes the money?
- 2.) Determine **HOW** much money?

Draw a Timeline



Calculate

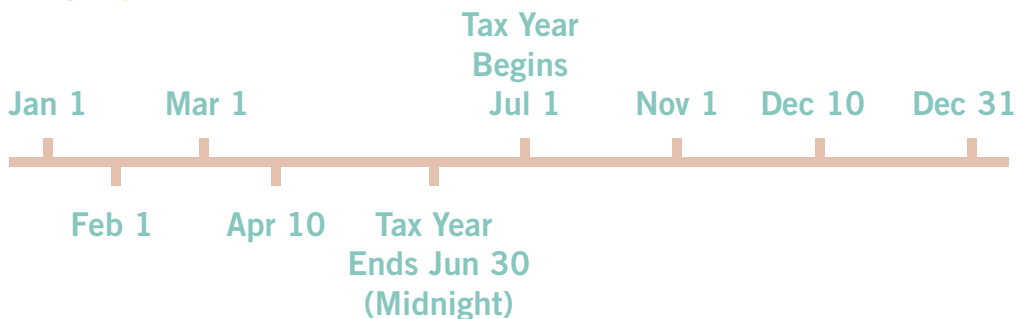
Prorations Worksheet

.....

Interest...(is paid in arrears)



Property Taxes



No Darn Fooling Around

Loan Considerations

Amount of loans: The amounts of the existing loans, new institutional loans, purchase money loans, and the charges for any new loans must be considered.

Existing loan amount: This amount will always be owed by the seller and will be a debit. It will be a credit to the buyer, if he/she is taking over the existing loan, as the buyer will not be required to pay the amount in cash at close of escrow.

New institutional loan: The amount of any new loan obtained by the buyer will be credited to the buyer, as the amount is paid into escrow for the benefit of the buyer. It will not appear on the seller's statement.

Amount of note to seller: The amount of the trust deed taken back by the seller as part of the purchase price will be debited to the seller and credited to the buyer. The seller will not receive that amount in cash at the close of escrow, and it will be credited to the buyer, as the buyer will not be required to pay the amount in cash at the close of escrow.

The buyer pays for recording the deed and other items of record that must be cleared to provide marketable title.

Purchase price: The purchase price will always be debited to the buyer as he/she agrees to pay that amount and will always be credited to the seller as the seller is entitled to receive that amount. However, the entire purpose of the closing the purchase price decreased by credits statement is to determine how much of the purchase price the seller is entitled to receive in cash. As a general rule, the seller is entitled to receive the purchase price, increased by credits and decreased by debits. The buyer will be required to by the purchase price decreased by credits and increased by debits.

Chapter 11 Summary

A **land contract** is a real property sales contract which provides that the seller (vendor) will act as the lender (by extending credit) and that he/she will hold the title to the property as security for the payment of the debt. The purchaser holds possession and equitable title.

An **option** to buy is a contract by which an owner, in exchange for consideration, gives another person the right to buy, and agrees to sell, a property within a certain time for a specified price and upon specified terms. The optionee obtains no legal interest in the property, only a right to buy. Consideration must be included but can be any amount.

The **escrow holder** handles all papers and funds in connection with real estate transactions. Escrow is a disinterested third party, authorized to act as the agent of both parties to the escrow.

All escrow proration are based on a 30-day month or on a 360-day year. This kind of standard is referred to as a **banking year**.

The first installment of property taxes is due **N**ovember 1st and become delinquent on **D**ecember 10th. The second installment of property taxes is due **F**ebruary 1st and become delinquent on **A**pril 10th.

Remember **N**o **D**arn **F**ooling **A**round to help recall the dates.

An **exchange agreement** is in the form of an offer and acceptance agreement, as is the purchase agreement. Exchanges can benefit investors in many ways and involve multiple properties and typically multiple commissions.

chapter 11 quiz

- 1. The sale of real property by a contract of sale gives the buyers:**
 - a. Right of possession.
 - b. An estate of inheritance.
 - c. A freehold estate.
 - d. All of the above.
- 2. The contractual agreement for the purchase of real property which is ordinarily used when a buyer does not have a large down payment is called:**
 - a. A security agreement.
 - b. A land contract.
 - c. A deed of trust.
 - d. An option agreement.
- 3. All of the following statements concerning the "Land Contract" method of financing the purchase of real property are true, except:**
 - a. Death of the seller might force litigation to obtain title.
 - b. Lending institutions consider land contracts to be poor collateral.
 - c. There is a possibility that the buyer would not get clear title.
 - d. The buyer is assured of obtaining title to the property upon completion of the terms of the contract.
- 4. A banking year is:**
 - a. 360 days.
 - b. 364 days.
 - c. 365 days.
 - d. None of the above.
- 5. Which of the following is most likely to cause a cloud on the title to real property:**
 - a. A locked in clause in promissory note.
 - b. A recorded real property sales contract.
 - c. A recorded homestead.
 - d. A private deed restrictions.
- 6. When times are hard and money for financing new purchases is scarce, a real estate salesperson would have a better chance of earning a living if he/she specialized in:**
 - a. The sale of industrial property.
 - b. Negotiating real estate loans.
 - c. the sale of residential property.
 - d. Exchanges of properties.
- 7. The following statement is true with the respect to options. An option is:**
 - a. Valid without consideration.
 - b. Valid if the consideration is exactly \$10.00 but is not delivered.
 - c. Valid if consideration is delivered even if it is less than \$10.00.
 - d. Not valid if the delivered consideration is less than \$10.00.
- 8. If escrow instructions, signed by both parties, contain terms in conflict with the original purchase agreement, the following is true:**
 - a. Escrow instructions will control.
 - b. The original contract will prevail.
 - c. A new contract must be drawn up between buyer and seller.
 - d. Buyer could demand that his/her deposit be refunded.
- 9. During escrow, if an unresolved dispute should arise between the seller and buyer preventing the close of escrow, the escrow holder may legally:**
 - a. Arbitrate the dispute as a neutral party.
 - b. Rescind the escrow and return all documents and moneys to the respective parties.
 - c. File an interpleader action in court.
 - d. Do any of the above.
- 10. The escrow agent usually is the agent of:**
 - a. Buyer.
 - b. Seller.
 - c. Buyer and seller.
 - d. Buyer, seller and third parties.



“I view real estate as the most intriguing opportunity that I’ve seen in my business lifetime.”

Richard Rainwater

CHAPTER 12:

taxes & recording

Learning Objectives

Working with investors in real estate requires knowledge of State and Federal tax laws to better understand their investment strategy. This chapter reviews some of the basic concepts of taxes and how to avoid or defer them by reviewing capital gain tax law, investment property exchanges and installment sales. We also discuss principles of title insurance and the sale of business opportunities.

key terms

1031 Exchange	CLTA	Street Improvement Act of 1911
Abstract of Title	Constructive Notice	Street Opening Act of 1903
Actual Notice	Cost Basis	Successors Liability
Adjusted Cost Basis	Direct Assessment	Title Plant
ALTA	Documentary Transfer Tax	UCC-1
Appreciation	Franchisee	Uniform Commercial Code
Bill of Sale	Franchisor	Vendee
Board of Equalization	Goodwill	Vendor
Book Value	Homeowner's Exemption	Veteran's Exemption
Boot	Installment Sale	Vrooman Street Act
Capital Gain		

Income Taxes

Both the State and Federal Governments impose an annual tax upon income received by taxpayers each year. This tax is a progressive tax. The amount of tax increases in some proportion to the amount of net income earned by the taxpayer. The income tax method of taxation is said to have a marginal tax rate. There is a sliding scale of taxes, computed annually, that currently varies from 0% to almost 50% depending upon the amount of your taxable income and your filing status. The bracket that your tax liability comes under depends on the next dollar of your income. One can be taxed on a portion of their income at 12% tax rate. The next dollar earned would put them in the 22% tax rate.

Often, a person with a real estate broker's license will buy and sell real estate on their own account. This action would involve the broker in dealing with what, for him/her, would be inventory. All income or profit would be treated as ordinary income for tax purposes since the broker would be a dealer in real property.

Tax consciousness should start prior to the acquisition of real property, continue during ownership and through its ultimate disposition. This would be good advice no matter what kind of investment opportunity an investor might consider undertaking.

Income or loss from real property comes from three main sources:

1. Rental operation of improved real estate.
2. Capital gain or loss from the sale of rental property.
3. Rent and capital gain or loss from undeveloped land defined as investment real estate.

Rental Operation of Improved Real Estate

Net income from investment property is reported as on an individual's personal income tax return.

All investment properties allow the deduction of operating expenses. From this viewpoint:

- ▢ Prepaid rent becomes deferred income but for income tax purposes, rent paid in advance is reported in the year received by the landlord.
- ▢ A security deposit is not income because it does not belong to the investor. It belongs to the tenant.
- ▢ In a cash operating statement, taxes and fire insurance premiums would be identified a fixed expense. The regular recurring costs or charges required in the holding of a property are designated fixed expenses.
- ▢ The deduction for a capital loss on income or investment property is limited to \$3,000 for each current year. Capital losses against a residence are not deductible expenses.
- ▢ Property used in a trade or a business is said to be a section 1031 asset, and consequently receives more favorable treatment. Such property has the normal advantages of investment property, such as deducting all expenses of care and maintenance, depreciation and capital gain treatment. However, it has an added advantage when the property is sold at a loss as the property is used in a trade or business the taxpayer is entitled to deduct the net loss as an ordinary loss against current income in many cases.

The following explanations of basis and adjusted basis are designed to assist in understanding how capital gain and loss are determined upon the sale of real property. The most common use of the term tax shelter is to describe the circumstances in which an operating loss and depreciation from rental real property is used to offset the taxpayer's taxable income from other sources, thus reducing tax liability.

Basis of Property

Property that is purchased has an original basis equal to its cost.

Cost basis: When property is purchased, its cost is the money you pay, the debt for which you become obligated and the fair market value of other property or services you provided in the transaction.

Example: A property was purchased on the following terms:

Cash	\$100,000
Assumption of Existing Loan	\$600,000
Assumption of Sewer Lien	\$50,000
Closing Costs	<u>\$5,000</u>
Unadjusted Cost Basis	\$755,000

Adjusted basis: Once the cost basis is established, certain adjustments can be made to it before gain or loss on sale can be determined. When all the additions and subtractions to basis have been made, the result is what is known as the adjusted basis of the property. Basis must be increased by the cost of any permanent improvements to the property, such as: adding a room, putting up a fence, installing a new roof, paving a driveway or installing a swimming pool. The basis of property must be reduced by the amount of depreciation claimed each year. Any depreciation which is not claimed when it is due is lost and cannot be claimed later. Principle payments increase equity but have nothing to do with basis.

The adjusted basis of a property exchanged becomes the basis of the property received.

Example:	Land	Building	Property
Original Cost of Property	\$100,000	\$600,000	\$700,000
Addition to Building		<u>150,000</u>	<u>150,000</u>
Total Cost:	\$100,000	\$750,000	\$850,000
Less Depreciation		<u>- 350,000</u>	<u>- 350,000</u>
Adjusted Basis	\$100,000	\$400,000	\$500,000

Capital Gains

The holding period to calculate capital gain profits or losses (2018 tax code) are:

- Investment property held twelve months or less is classified as a short-term capital gain or loss.
- Investment property held more than twelve months is classified as a long-term capital gain or loss. The 2018 capital gains tax on long-term investments is a maximum of 20%.

For investors in the business (e.g., of buying and selling real property) there are no tax advantages provided for capital gains under present law. They must be included with other forms of ordinary income and are taxed accordingly. On the other hand, a capital loss on property held for investment may be deducted from other ordinary income.

Raw land held for investment cannot be depreciated. The only income tax consequences that are available are in the capital gain or loss at the time of sale.

Principal Residence Property

Residence property is defined as the owner's principal place of residence. If it is a single-family home, it is entirely residence property. If it is a unit in a multiple unit dwelling than that proportionate part of the property in which the owner resides is the taxpayer's principal residence property.

The owner of a residence is limited to income tax deductions to real property taxed, interest on the loans and any uninsured loss. Prepaid interest (points) can be deducted in the year paid. If the owner decides to pay off the loan the prepayment penalty can be deducted as interest. Beginning in 2018, couples filing jointly can deduct the interest on loans up to \$750,000 of qualified loans.

The capital loss on the sale of a personal residence is not deductible for income tax purposes.

The tax on the gain that a taxpayer realizes from the sale of his/her principal residence is considered a capital gain only to the extent that the gain exceeds \$250,000 in the case of a single person and \$500,000 if married.

The \$250,000 or \$500,000 can be excluded from profits above basis once every two years. The property must be a principal residence of both taxpayers for a minimum of two years. There are no limits on the number of two year sales periods wherein this can occur. There are no age limitations placed into this law.

Installment Sales

Federal law permits the taxpayer who sells under a land contract and retains title to the property to receive payment from the sale of the real property over a period of years and to pay the taxes due on any capital gain as it is received each year. He/she does not have to pay the tax on the entire gain in the year of the sale. This provision is moot because of the large \$250,000 and \$500,000 capital gain exclusions on personal residences.

Tax-deferred Exchanges (IRS Section 1031)

If you trade investment or business property for other investment or business property of a like-kind you postpone tax on the gain or postpone deduction of the loss until you dispose of the property you receive in the exchange. This is commonly referred to as a tax-free exchange. However, the following conditions must be met:

- The property you trade and the property you receive both must be held by you for business or investment purposes. Neither property may be held for personal purposes such as your residence.
- The property traded and property received must not be property sold to customers. It must be property held for productive use in a business or held for investment.
- It must be like-kind property. This means that the real estate must be exchanged for real estate and personal property exchanged for personal property. The trade of an apartment house for a commercial building is a “like-kind” exchange as it involves trading investment or business real property for investment or business real property.

Boot

If you receive cash or unlike property in addition to the “like-kind” real property received in the trade, you are said to have received boot. Under these circumstances you are taxed on the gain realized in the exchange – but only to the extent of the cash and fair market value of the unlike property you receive.

Example: “A” exchanges an 8-unit apartment with an adjusted basis of \$90,000 for a duplex with a fair market value of \$190,000 and also receives \$10,000 cash and a note with a fair market value of \$5,000.

Calculations:

Fair market value of duplex received	\$190,000
Adjusted basis of 8 units given	<u>90,000</u>
Difference = realized gain	\$100,000
Part of realized gain that is taxable:	
Cash received	\$10,000
Unlike property received (note)	<u>5,000</u>
Recognized as taxable gain	\$15,000

The remaining \$85,000 gain (\$100,000 realized gain less \$15,000 taxable gain) reduces the basis in the newly acquired property by \$85,000, and is tax-deferred.

Mortgage Relief

In addition to boot in the form of cash and unlike property such as notes and personal property, the exchange may also involve a form of boot known as mortgage boot or mortgage relief. When another party to the exchange assumes a liability of the taxpayer or acquires property subject to a liability as part of the consideration to the taxpayer, the relief of such liability is considered as mortgage boot. Potential gain from the transaction is taxable to the extent of mortgage boot received unless offset by boot given.

Example: The agreed value of A's property is \$200,000. It is encumbered with a trust deed securing a note for \$50,000. The agreed value of B's property is \$170,000. It is encumbered with a trust deed securing a note for \$40,000. They agree to exchange properties, assume the liens on the property received, and pay cash for the difference in equities.

Analysis:

(A)		(B)
\$200,000	exchange value	\$170,000
<u>50,000</u>	loans	<u>40,000</u>
\$150,000	equity	\$130,000

\$20,000 (\$150,000 - \$130,000) boot

\$10,000 (\$50,000 - \$40,000) relief

\$30,000 total boot received

Exchange party "A" is subject to taxes on the amount of the total boot received.

If a property is taken by a local government under the powers of eminent domain, the money received from the condemnation is identified as an involuntary conversion. It is treated like a sale or exchange of property. The taxpayer is given a period of time to convert the money received into a like property. If property is converted involuntarily into other property similar in nature and use, no gain will be recognized on the exchange. The taxpayer (owner) transfers his/her basis over to the new property in the conversion as if nothing had happened. If the property was a capital asset or was used in the owner's trade or business, the owner can take the holding period for his/her old property onto the new.

Depreciation

Care must be taken when discussing depreciation of real property. The concept of depreciation is different when applied to the appraisal of property than when used in the context of the income tax considerations of property.

When appraising real property, depreciation is determined by an estimated actual loss of value from any cause. The three chief causes of depreciation are:

1. Physical deterioration
2. Functional obsolescence
3. Economic obsolescence

Residence property, no matter where it is located, does not qualify for depreciation deductions in income tax matters. Unimproved land also is not depreciable. A property improved for investment would be depreciable as far as the improvements are concerned.

When determining depreciation for income tax purposes, a cost recovery system is presently used. Each new owner establishes a new period of time and their own method to be used.

Depreciation allows the owner to recover the cost of improvements over a fixed recovery period. The length of the recovery period varies according to the type of the property.

From the accountant's viewpoint, depreciation is a mathematical calculation that is taken as an income tax deduction and accrued each year. **Book value** is an accounting value of an asset based upon its original cost plus capital additions minus accrued depreciation. A depreciation deduction is allowed only for improvements. Land may not be depreciated. When the property is fully depreciated, its book value consists of the original land cost. Improvements have been written off the books.

Depreciation Calculation Methods

Residential real property is one of nine property classifications currently used by the IRS. Residential real property includes buildings or structures where 80 percent (80%) or more of the gross rental income is from dwelling units. This excludes hotels, motels and motor inns. The system of calculating depreciation is straight-line over 27.5 years.

Home Mortgage Interest

Current rules make a distinction between a loan incurred to build, buy or make a major improvement to a home referred to as acquisition debt. Loans placed against the home after its purchase to obtain funds for personal purposes referred to as home equity loans.

Acquisition Debt

Interest on acquisition debt of a loan amount up to \$1 million dollars is deductible if the loan is secured by a home. A boat, recreational vehicle or mobile home can qualify as a home for regular income tax. However, boats do not qualify as a home when figuring the alternative minimum tax. The alternative minimum tax (AMT) method of calculating tax liability is required of taxpayers with a high percentage of tax sheltered or tax favored income.

Home Equity Loans

On home equity loans in an amount up to \$750,000, the interest is deductible no matter how much the home cost to buy or build. This \$750,000 home equity ceiling applies to the total of all home equity loans and previous loans.

Refinancing

Refinancing an existing loan is permitted. However, any funds received above the present loan balance (not the original amount of the loan) is considered to be home equity, subject to the \$750,000 limitation. Refinancing the loan on a home will not be a cause for the county assessor to raise taxes.

Tax Shelters

In the widest meaning, a tax shelter exists whenever a transaction can be treated for income tax purposes in a manner that does not reflect true economic reality and results in the taxpayer having less tax liability or none at all. Congress often legislates a tax shelter to promote a public policy, for example, home ownership. An example of this type of tax shelters are:

- ▣ No tax is due on profits above \$250,000 above “basis” on the sale of a personal residence of a single person.
- ▣ No tax is due on profits above \$500,000 above “basis” on the sale of a personal residence of a married couple. These “tax free” sales can be made every two years. The property must have been lived in for at least two years during the previous five years.

It should be pointed out at this point that the interest paid on the loans that encumber the home as well as the real property taxes, are also a tax shelter because they are deducted from ordinary income in the calculation of both state and federal income tax.

On the other hand, the homeowner (as opposed to the tenant) must weigh these tax benefits against the loss of income from the investment of his/her equity monies as well as real property taxes not paid as a tenant.

Another great advantage of ownership is leverage. Leverage is the use of credit (borrowed money) used to purchase a property. When a property is 80% leveraged it means a debt on the property of 80% of its value. The owner’s equity is 20%. The lower the down payment

and the longer the loan (reduced payments) the greater the leveraged position. “Trading on equity” is just another term used to describe what we usually identify as leverage. For example:

An apartment building was purchased for \$200,000 by making a down payment of \$50,000. One year later its market value was 10% higher than the purchase price, causing the owner’s equity to increase by 40%. This is an example of how an owner can profit because of leverage.

Other tax shelters include:

- ▢ When a person dies, leaving appreciated assets, real estate or otherwise, the estate or heirs may sell the assets without income tax liability on the appreciated value.
- ▢ By means of a tax-deferred exchange or an installment sale, tax liability may be deferred to the future.
- ▢ Depreciation deductions may be used to reduce the current taxable income from the property and possibly income from other sources.

Elimination or Reduction of Tax Shelters

The Tax Reform Act of 1986 either eliminated or severely limited the following tax shelters:

- Conversion of ordinary income to capital gain to provide the taxpayer a long-term capital gains deduction is no longer possible.
- The amount of losses deductible by the investor have been limited to the cash down payment plus certain types of mortgage loans. Loans extended by the seller to the buyer may not be included in the amount “at risk” by the investor, thereby reducing the amount of the buyer’s investment that may be deducted as losses.

Business and Investment Losses

Prior to the passage of TRA 86, tax losses (generally created by depreciation deductions taken against operating income) of a real estate rental property, such as apartment houses or office buildings, could be used as an offset against the taxpayer’s other income from salaries, dividends, interest, net capital gains, royalties and so forth. This was commonly called a deep tax shelter, as the depreciation deduction not only sheltered the income from the real property from taxation, but created a loss that was carried over to shelter other ordinary income from taxation.

The Tax Reform Act of 1986 has severely curtailed this deep tax shelter by creating three classifications of business activity and limiting the carry over of losses from one activity to the other. The three types of activity are:

1. Active trade or business
2. Portfolio activity
3. Passive activity

Active Trade or Business

An active trade or business is one where the owner materially participates on a regular, continuous, and substantial basis in the conduct of the business. If a taxpayer materially

participates in an active trade or business (other than real estate), tax losses from the trade or business may be deducted without limit against the taxpayer's other income.

Portfolio Activity

Investments, such as stocks and bonds, create portfolio income. Interest, dividends, royalties, annuity income, and capital gain or loss resulting from the sale of portfolio assets are examples of portfolio income.

Passive Activity

Passive business activities are any activities carried on for a profit, except: active trade or business with material participation and portfolio activities.

All real estate rental activity has been declared to be a passive activity with one exception the "\$125,000 exception" which is discussed in later paragraphs.

A major change in real estate investment was introduced by the TRA 86 rule that annual tax losses from passive activities may be used as an offset against passive income only. Passive losses may not be used to offset ordinary income, except for the \$25,000 real estate rental property rule which states Passive investment losses of up to \$25,000 that result from rental income property can be deducted by the taxpayer, provided the party's adjusted gross income is less than \$100,000 and the party "materially participates" in the management of the property.

Any unused passive losses are suspended and may be used to offset future passive income, or offset capital gain when the asset is sold.

In effect, this removes the deep tax shelter provided by real estate investment, where the paper loss could be used to shelter the investor's ordinary income.

Real Estate Rental Activity - \$25,000 Exception

The only exception to the rule that classifies real estate rental activities as passive and limits losses is the rule that permits the individual taxpayer to deduct up to \$25,000 of rental real estate losses against the taxpayer's ordinary income such as salaries and wages.

To be eligible for this exception the owner must actively participate in the real estate rental activity. Participation in a real estate rental activity is not as strictly defined as material participation in an active trade or business. In rental real estate, active participation permits the use of a property manager, if the owner performs some management duties. An owner may participate by actual execution of leases, approval of major expenses or making mortgage payments.

There is also an income ceiling to be eligible for the \$25,000 loss carryover exception for rental real estate activity. The \$25,000 deductible loss carryover is reduced by 50% of the taxpayer's adjusted gross income over \$100,000. Thus, when the taxpayer's adjusted gross income reaches \$150,000 the right to deduct any rental real estate loss against ordinary income is lost.

Property Taxation

The right of taxation is one of the sovereign powers of the state. It is the right by which the state levies a charge against property for the purpose of securing money to defray the costs of government.

In taxation, there is no contractual relationship between the state and the property owner, and there is no limitation on the right of the state to impose taxes, except that the taxes levied shall be uniform. The right of the federal government to impose income taxes was granted by an amendment to the constitution. The form of tax imposed is called ad valorem (according to value).

Real Property Taxes

The tax on real property is one of the oldest forms of taxation. Historically, local taxing powers chose land as the principal source of tax revenue. The amount of land owned by a person gave indication of his/her proportionate wealth and ability to pay. Another reason for taxing land is the fact that it is so easily accessible and cannot be concealed from the tax collector. Whether the property be residential, land, or income producing, outside of mortgage interest, real property taxes are the highest operating expense.

The assessment of taxes plays an important part in the economic health of a community. Any community will suffer from the effects of a property tax rate that is inordinately high. New ventures would be discouraged by the prospect of the future tax burden. If established firms could find relief by moving to a new location, they would do so. Under these circumstances, new assessment bonds would be difficult to market. Investment money would be turned away as the prospects of making a profitable return would be more difficult.

The state and federal governments, theoretically, could tax real property but do not do so. They depend on income taxation for their principal source of revenue. It can be said, therefore, that real property is subject to taxation by city and county only, but not by the state or federal governments.

The tax imposed on the ownership of real property becomes a lien as a matter of law without recording and, if not paid, the lien may be foreclosed and the title sold to satisfy the lien.

In California, property taxes become a lien on the first day in January prior to the fiscal year in which they become due. The amount is not yet known and will not be known until the owner receives his/her tax bill some months later.

Real property tax assessment rolls now reflect California's policy of showing that real property assessment values are set at 100% of the property's market value at time of purchase. They also reflect the total assessed valuation available for taxation in each county.

Steps in Taxing Real Property

Step 1: The total assessed value (market value) of all properties subject to taxation in each county is determined through the work of the county tax assessor. The tax rate is now one percent 1% of the market value at time of purchase of each parcel of real property. By special vote approved by the voters this may be increased for specific purposes. A legal description is not necessary to a valid tax bill.

Market value, in accordance with the provisions of Proposition 13, (1978) reflects the appraised value of the property on the lien date in 1975 (March 1st) or the re appraised value of the property since that date. If the property has not been appraised to its current value level since 1975, an inflationary factor of a maximum of two percent (2%) per annum may be added for each year after 1975. The assessed value is subject to adjustment any time that new construction is added to the property or that a change of ownership takes place.

Step 2: Using the pool of assessed value developed by the tax assessor, the board of supervisors determines the tax rate (and therefore the tax bill) for the coming tax year which will produce the needed revenue to meet the county (city) budget requirements. The base tax rate, by law, cannot be greater than 1% of the parcel's market value. Tax amounts are calculated by multiplying the assessed valuations at a rate of one percent (1%) of the property's assessed value. However, there could be additional levies added to the 1% limit. These would be levies passed by the voters for specific purposes. They cause the total levy to be somewhat greater than one percent (1%).

Step 3: The tax collector of the county (city) will bill the property owners and collect the taxes due for the cities, counties, school districts, and all other legitimate taxing agencies in the tax collector's jurisdiction.

Exemptions

Not all real property is subject to taxation. Clearly, there can be no tax imposed on publicly owned property such as lands, public buildings, parks, streets, etc. Privately owned property which is owned by religious, hospital, charitable, or educational institutions where a public service is performed on a nonprofit basis is specifically exempt.

Usually, land is assessed as to its highest and best use. Thus, a lot zoned R 4 is assessed as an R 4 property even though it is improved with only a single-family residence. In order to promote the creation of open space areas, the law exempts such areas from the general rule. Open space areas are assessed as such even though they are improved with buildings.

As a rule, things planted in the ground become real property and are taxable as such. However, by law, growing crops are exempt, as they must be planted each year. Also exempt are grapevines less than three years of age, fruit and nut trees less than four years of age, and date trees less than eight years of age, because they do not produce a commercial crop until they are mature.

Homeowner's exemption: Every owner of an owner occupied single family residence, condominium, multiple dwelling unit, and cooperative apartment may be eligible for a \$7,000 exemption from the property's assessed value. The homeowner must apply for the exemption. Once granted, the exemption remains in effect until terminated. The property owner does not qualify for this exemption if he/she does not occupy the property as his/her principal residence as of the lien date (January 1) or if the property is altered to such a degree that it is no longer a dwelling place which may qualify for this exemption. Some counties have exemptions for senior citizens.

Veteran's Exemption: Every qualified veteran who was a resident of California upon entering the service or a resident of the state prior to November 3, 1964 is entitled to an exemption of \$4,000 of the assessed value provided that: application for the exemption is made each year between January 1 and April 15, and if single, the market value of personal property and the value of real property owned by the veteran is less than \$5,000. If married, the market value of personal property and the value of real property owned by the veteran and his/her spouse must be less than \$10,000. When determining the value of real property, solely for determining the veteran's eligibility for this exemption, only 25% of its market value is taken into consideration. This treatment of real property was initiated to maintain the same proportion of value as existed when real property was assessed at only 25% of its market value.

A homeowner under the above exemptions may have both a homeowner's and a veteran's exemption; however, they cannot be applied on the same property.

Tax Calendar and Procedure

January 1st: (Prior to the fiscal tax year). Taxes become a lien on the property on this date each year. The person to be assessed is the owner of the property on that date.

July 1st: The fiscal tax year begins. All government and budget matters operate on what is known as a fiscal year or tax year. This twelve month period runs from July 1st, terminating at midnight on the following June 30th. July 1st to July 1st is the more common designation. Identification of this period is expressed by a statement of the two calendar years involved, i.e., 2016-2017 taxes.

July to August: The Board of Supervisors of each county is required by law to sit as the county board of equalization for at least three weeks beginning on the first Monday of July. It has the power to adjust assessed values of property upon appeal by the taxpayer. This does not apply in counties using Assessment Appeal Boards.

August: The final assessment roll is adopted by the board and turned over to the County Auditor who arrives at the total assessed values of all assessable properties. The Board of Supervisors then follows a prescribed formula to arrive at the tax rate. The law requires that this be determined by September 1st of each year.

September through March: In counties that have Assessment Appeals Boards, taxpayers may request a hearing to change the assessed value. If the board grants a reduction and the taxpayer has paid the taxes (due November 1st), he/she may obtain a refund plus interest if the interest exceeds \$10.

November 1st: The first installment (one-half the real property taxes plus personal property taxes, if applicable) of the taxes becomes due. If the taxpayer desires to pay the total tax, he/she may do so.

December 10th: The first installment becomes delinquent if not paid by 5:00 p.m. at which time a penalty of 10% is added to the first installment.

February 1st: The second installment becomes due.

April 10th: The second installment becomes delinquent and, if not paid by 5:00 p.m., a penalty of 10% is added to it.

A good way to remember these dates is the phrase, No Darn Fooling Around. November 1st is the due date for the first installment. December 10th is the delinquent date. February 1st is the due date for the second installment and April 10th is the delinquent date.

June 8th: Annually, on or before June 8th, the tax collector publishes a notice of impending default for failure to pay taxes on real property which will be unpaid by the close of business on the final day of the fiscal year. Next, on or before June 30th, at the time fixed in the notice of impending default, the taxes, assessments, etc., which are unpaid shall by operation of law and declaration of the tax collector, be in default. In an instance in which property taxes are delinquent more than one year it is declared to be in default at the tax collector's stamp sale which establishes the beginning date of the legally established delinquency redemption period. Such property, henceforth, will be designated tax defaulted property. (Formerly, the property was said to be "sold to the state" at this point, even though no transfer actually took place.) Finally, on or before September 8th, the tax collector publishes an affidavit stating that the real property on which the taxes, assessments, etc., are unpaid, are in default together with a list of all such properties.

The tax collector will transmit a proper copy of this list to the State Controller. Under current law, five years after the property becomes tax defaulted, the tax collector has the power to sell such property, or any portion of it, as he/she sees fit. He/she then publishes a notice to this effect. Any person may purchase the property at such a sale. During the five-year redemption period, such taxpayers are not disturbed in the possession of their property. In addition to the amount of the delinquent taxes, the tax collector will collect a charge of \$10 on each item of property for preparing a delinquent roll and there is a redemption fee of \$15 plus a redemption penalty of one and one half percent per month during each year that the taxes remain delinquent. Unless redeemed, subsequent tax bills may contain language (e.g., "prior year taxes delinquent, etc.") indicating that title to the property is in jeopardy because of delinquent prior year taxes.

Redemption of Tax Defaulted Property

Tax defaulted property may be redeemed by the owner or his/her successor in interest upon payment of taxes, interest, costs and penalties, including “redemption penalties.” The redemptioner may receive a certificate of redemption as evidence of payment. Delinquent taxes and penalties may be paid in five annual installments and redemption is then complete, providing current taxes are paid as they become due.

Five years or more after the declaration of default, a statutory power to sell the property arises by operation of law. However, title remains with the assessee and the lien for taxes would remain in effect. This declaration is preceded by a notice to the assessee and a published notice of default and power to sell for nonpayment of taxes. A notice of the power to sell is recorded by the tax collector. Should the property be sold for the taxes due, the highest bidder receives a tax deed.

At that time, the tax collector is authorized to sell the property to a third-party purchaser or by agreement to the state, a county or public agency. In either case, not less than 45 days nor more than 60 days prior to the sale, all parties with interests in the property will be notified of the sale by registered mail so that they will have the opportunity to protect their interests. Once a sale or agreement is completed, the right of redemption terminates. Parties with interests in the property have a right to the excess proceeds from a sale or agreement.

Personal Property Taxes

In addition to the tax on real property, taxes are also imposed by cities and counties on tangible personal property. The personal property tax becomes a lien on the first day in January just before the fiscal year in which it becomes due, the same as the real property tax. In some counties, all the personal property taxes become a lien on real property and are billed and collected with the real property taxes. In other counties (among them Los Angeles County), the entire tax on personal property located on real property owned by the taxpayer is payable with the first installment of the real property taxes. Personal property not located on real property owned by the taxpayer is billed separately. Other counties divide the tax into two installments on the real property tax bills and some present separate personal property tax bills on all personal property owned by the taxpayer.

If the personal property tax is payable with the real property tax bill, it is a secured tax, being a lien on the real property. Where a separate tax bill is presented, it is called an unsecured tax and is not a lien on real property. The separate personal property tax bill is due upon presentation and becomes delinquent at 5 pm on August 31st.

Exemptions

Certain personal property is exempt from taxation, such as that which is used by public service, by privately owned non profit organizations, household furnishings and personal effects, shares of stock and promissory notes.

Special Assessment Tax

Whenever there is a public improvement which, at least in theory, improves the value of or benefits privately owned property, the property owners so benefited are required to pay for such improvement. Improvements may consist of a variety of things such as street paving, street lighting, public parks, etc. Such improvements are often referred to as offsite improvements.

The law permits the county tax assessor to prepare and file in his/her office maps showing parcels of land designated by number or letter. Land may be described by a reference to such map for assessment purposes.

Assessments of this nature are capital improvements to the property and therefore increase the basis of the owner. The Revenue and Taxation Code of California states that such assessments become a lien when they are fixed by the governing body with power to set such a levy.

The tax may be imposed through an Assessment District or directly upon the properties benefited. Whatever the method, the district, city, or county will issue improvement bonds in order to raise the necessary funds and give them to the contractor involved or sell them directly to investors. The bonds become a lien on the property when they are known and fixed. They are payable along with the real property tax bill over a period of years, depending upon the particular improvement act itself. Usually, the taxpayer is presented with a bill in the amount assessed against his/her property and if it is not paid within 30 days it becomes a lien on the property and is said to have "gone to bond."

Assessment bonds run with the land. They do not need to be paid off at the time of sale but may be assumed by the buyer.

Vrooman Street Act: Permits cities to improve streets and install public sewers. Bonds may be voted upon to cover costs and be retired by a tax levy. Public utilities also may be acquired in this way.

Street Opening Act of 1903: Applicable to both cities and counties, this act permits authorities to build new streets or highways or improve old ones and to secure property for this purpose. Surrounding property owners are assessed according to the benefits they receive from the improvements.

Street Improvement Act of 1911: This law is used frequently to finance street and highway improvements. Again, property owners are charged per front foot with a share of the costs, the amount depending upon how much they are benefited. This is the most commonly used special assessment law.

Direct assessment: A direct assessment is one levied against an individual parcel of land and becomes a lien upon such parcel. Customarily, if such an assessment is under the sum of \$150, it is due and payable when levied. If it is over \$150, and not paid in 30 days, a bond is issued against the individual parcel of land.

Board of Equalization

A function of the State Board of Equalization is to appraise properties owned by public utility corporations and allocate the assessed values between the counties involved with these huge and scattered properties.

The State Board of Equalization also has the function of collecting the sales tax on the sale of tangible personal property. All records of unremitted sales taxes will be found by requesting that information from this source.

Other Taxes

There are other types of taxes such as income, business license, excise, estate, inheritance and gift taxes, as well as the sales tax, which is discussed in connection with business opportunities.

Business License Tax (Gross Receipts Tax)

Some cities and counties impose a tax on all persons engaged in a business venture or a professional practice within its boundaries. The tax is computed upon the gross receipts, or is a specified annual amount, depending upon the city or county. Thus, a real estate broker operating an office in a city where such tax is imposed, would be required to pay this tax in addition to the license fees paid to the Department of Real Estate.

Documentary Transfer Tax

The Documentary Transfer Tax Act allows cities and counties to adopt a tax known as a transfer tax on the conveyance of title to property with some exceptions. This revenue is collected by the county recorder and the document must state that it has been paid.

A deed is required to be taxed if the consideration, exclusive of the value of any liens remaining at the time of sale, exceeds \$100. The tax is computed at the rate of 55 cents per \$500 of consideration or fraction thereof on all cash and new lien encumbrances.

This tax is not figured on the value of any encumbrance which is already on the property and which is being taken over by the buyer. It applies to cash and new encumbrances only. New encumbrances include trust deeds taken back by the seller as part of the purchase price. Trust deeds themselves, which are conveyancing instruments because they transfer bare legal title to a trustee, are not taxed. A deed will not be recorded if the tax is not paid. The county recorder must note the amount of tax on the deed. At the request of the person recording, this notation may be affixed after the deed is recorded. The county recorder will not record unless the amount of tax due is paid and attested to by a party, parties, or agent to the transaction.

Transfer Tax Sample

\$100,000	=	sales price
\$-60,000	=	existing loan assumed
\$-25,000	=	cash down payment
<u>\$-15,000</u>	=	new 2nd. Given by owner
\$100,000	=	total sales price
<u>\$-60,000</u>	=	old money - not taxable now (an existing loan)
\$40,000	=	new money - taxable now (cash and new loan)

The levy is .55 cents per \$500 or any fraction of \$500. This would be the same as \$1.10 per \$1000. In this example 40 (thousands) x \$1.10 = \$44.00 documentary tax.

If on the other hand there was a new first loan of \$60,000 the entire sales price would be new money. 100 (thousands) x \$1.10 = \$110.00 documentary tax.

State Inheritance Tax and Gift Tax

The California Inheritance Tax and Gift Tax were repealed as the result of the passage of Proposition 6 at the election held on June 8, 1982. The repeal is effective for estates of those decedents who died on or after 8:00 p.m. of June 8, 1982, and is effective as to all gifts made on or after that same hour on June 8, 1982.

The provisions of Proposition 6 also established a California estate tax. The purpose of this tax is to take advantage of a provision in the federal law which allows the estate to claim a credit against the federal estate tax for death taxes paid to the state. The tax is fixed in the maximum amount that the federal government will allow as a credit against the federal estate tax for death taxes paid to the state. It should be noted that this tax does not cost the estate anything due to the fact that if the amount were not paid to the state, it would have to be paid to the federal government.

Federal Estate & Gift Taxes

Under current law (2018) each of us can give away or leave up to \$11.2 million without owing federal gift or estate tax. For example, if you give your children your home worth \$1 million and stocks and bonds worth \$4 million, no federal gift tax is due. This exemption is indexed to inflation and goes up each year.

Various deductions such as mortgages, funeral expenses, debts and fees may be deducted to determine any taxable amount. Any property left to a surviving spouse does not get taxed at the death of the first spouse.

The Federal Gift Tax applies to completed voluntary transfers by an individual of any type of property for less than an adequate and full consideration in money or money's worth. If the transfer is of a present interest, a yearly exclusion of \$14,000 per donee is allowed (2017), \$28,000 per couple. If the gift qualifies for this exclusion, no return is due. If a gift to any donee exceeds \$14,000 in a year, a return is due. A return is due regardless of value if the gift is of a future interest. Certain types of transfers are no longer considered gifts. Hence, no

return would be due. Even though a return may be due this does not mean that the gift will be taxable. For example, transfers between spouses are not taxable. Under federal tax law, the basis of property acquired by heirs as an inheritance, bequest or devise is the fair market value of the property the day prior to the death of the decedent.

Since the tax code changes every year, always check with your tax professional.

California Sales and Use Tax Provisions

Upon the sale of any business holding a sales tax permit it is necessary to pay a sales tax on the furniture, fixtures and equipment sold. It is essential for buyer and seller to understand that this is paid by the seller on his/her final sales tax return, but the cost is paid by the buyer. It is evident that considerable trouble can arise if the purchaser does not fully understand this. Usually, it is necessary to get a final clearance form from the State Board of Equalization to close the escrow, and the broker should inform the seller to attend to such matters as soon as possible to avoid delay in closing.

Successor's Liability. The requirement that a successor or purchaser of a business or stock of goods withhold sufficient of the purchase price to cover the tax liability of the seller to pay sales tax due at the time of sale, arises only in the case of the purchase and sale of a business or stock of goods under a contract, providing for the payment to the seller or person designated by him/her of a purchase price in money or property, or providing for the assumption of liabilities and only to the extent of that purchase price, and does not arise in connection with other transfers of a business such as assignments for the benefit of creditors, foreclosures of mortgages, or sales by trustees in bankruptcy.

The amount of the dollar liability of the purchaser of a stock of goods would include:

1. The taxes incurred in the operation of the business by the former owner,
2. The taxes due because of the sale of the business,
3. Any interest due on the amounts listed in (1) and (2) above,
4. Any penalties chargeable to the seller for negligence or any willful disregard by the seller of the Sales and Use Tax law, or any rules and regulations of the Alcoholic Beverage Control Board,
5. And finally any penalty payable by the seller for fraud or an intent to evade the taxes due and unpaid at the time of the sale.

The purchaser of the business or stock of goods will be released from further obligation to withhold from the purchase price if he/she obtains a certificate from the board (clearance receipt) stating that no taxes, interest, or penalties are due from a predecessor.

All persons or firms in the business of selling tangible personal property in California must secure a "sales tax sellers permit" from the State Board of equalization, frequently referred to as a "Resale Number." These sales tax permits cost nothing. They are obtained using a form provided by the Board. A permit must be secured for each separate place of business and must be displayed at each location. They are good until revoked. Wholesalers as well as retailers must retain these permits.

The Use Tax is a liability of the purchaser and he/she must pay it to the state unless the retailer has collected the tax as a sales tax under the provisions of the sales tax law. The law also states that any sales or use tax must be listed separately on any sales document.

Recording

California originally operated as a possession of Spain. It later came under Mexican rule. It finally became a possession of the United States in 1848 with the Treaty of Guadalupe Hidalgo. California was admitted to statehood in 1850. There was no registry or recording laws under the two previous governments and, as a result, no clearly defined records reflecting ownership of property.

When California became a possession of the United States there was great confusion as to land titles and property rights. In 1851 Congress passed an Act providing for the appointment of a Board of Land Commissioners to determine these rights, and when California was admitted to the Union, one of the first acts of the Legislature of California was to adopt a recording system. The system adopted was modeled after the one established by the American Colonies and in use in many of the eastern states at that time.

The Recording Act of California provides that, after being acknowledged by the person giving the interest in the property, any instrument or judgment affecting the title to or possession of real property may be recorded. The instruments which affect real property are formal or legal documents, such as deeds, mortgages, trust deeds, leases, and contracts of sale.

There are many other documents which may, and in some cases to be effective, must be recorded. Documents which **MUST** be recorded to be effective include: Mechanics' liens, notices of completion, notices of non responsibility, abstracts of judgment, homestead declarations, declarations of abandonment of a homestead, subdivision maps, attachments, tax deeds, certificates of discharge, reconveyance deeds., notices of default, notices of sale, and a number of others.

However, the general intent of recording statutes is to permit, rather than require, the recording of any instrument which affects the title or possession of real property, and to penalize the person who fails to take advantage of the privilege of recording. Recording itself (except for a few instances, such as a declaration of homestead) has no bearing on validity, since it is simply a matter of notice. An invalid document is not validated by recording and a valid instrument need not be recorded, unless the parties so desire.

When one records a document, he/she or she is simply making that document become a part of the public record maintained in that county. Documents relating to real property transactions are recorded, generally, in the county in which the affected property is located. A legal description is essential to assure a correct filing.

Constructive Notice

Recording of an instrument imparts constructive notice, and instruments affecting real property must be recorded in the county in which the property is located to give such notice. If the property lies in more than one county, the instrument, or a certified copy of the record, must be recorded in each county in which the property is located in order to impart notice.

As indicated above, constructive notice is notice given by the public records. Generally, the law presumes that one has the same knowledge of instruments properly recorded as if he/she were actually acquainted with them. Every citizen has a right under the freedom of information laws to inspect the public records.

Actual Notice

Actual notice is said to consist of “express information of a fact.” There are two general circumstances which give rise to “actual notice.”

1. Where a person does in fact know, of his/her own knowledge, that a certain transaction has taken place.
2. Where circumstances exist that indicate a person should have had knowledge of the fact.

If a person accepts a deed, lease, or encumbrance from another who is not in physical possession of the property involved and there is another person such as a tenant who has actual possession, the person accepting the deed, lease, or encumbrance is held to have notice of the rights of the person in actual possession. The reason for this is that investigation by the person accepting the interest would have disclosed the interest of the person in possession and he/she, therefore, is held to have knowledge of the interest of the party in possession.

Recording Index

When a document is filed for recording in the county recorder’s office, it is stamped with the date, time and document number, as well as the book and page number where the copy of the document may be found in the records. The recorder may combine the general index of grantors and the general index of grantees into a single index which shall alphabetically combine the grantors and grantees. Where such a combined index is used, the names of the grantors shall be distinguished from the names of the grantees by an easily recognizable mark or symbol.

Government Code §27321.5 states: “Before acceptance for recording, in addition to every deed or instrument executed to convey fee title to real property, shall have noted across the bottom of the first page thereof the name and address to which future tax assessments may be mailed.”

Priorities of Recording

Usually, an owner of real property holds his/her title subject to various claims upon it. These may be voluntary encumbrances such as mortgages and trust deeds, or involuntary claims which, through operation of law, affect interests in the property.

From a practical standpoint, the subject of priorities of recording is concerned with the order in which they have a claim upon the property with reference to the time and date when “constructive notice” of each claim is made.

While it is true that the instruments themselves may be valid in the order in which they were executed, the recording system of California provides that an instrument executed first in time may not take precedence over subsequent claimants if the subsequent parties have acted in good faith and for a valuable consideration and recorded their interest first. It would seem, therefore, that the general rule of priority might be that those first to record are first in right.

Although it may be said that this is the general rule, there are four important exceptions:

1. Taxes and assessments
2. Mechanics’ Liens.
3. Agreements.
4. Actual Notice.

This factor of priority is of special importance in connection with mechanics’ liens for, as previously explained, such liens all relate back in priority of claim to the time of the commencement of the work as a whole. This is the reason for the rule that a deed of trust must be executed and recorded prior to the commencement of any work at all, if it is to take priority over any subsequently filed mechanics’ liens.

Acknowledgment

An acknowledgment is a declaration that a person has executed an instrument and that it is done of his/her own free will. An acknowledgment must be declared before someone authorized by law to take acknowledgments, usually a Notary Public. A fingerprint, usually the right thumb print of the signing party, is now required on many documents, including deeds.

Section 27228 of the Government Code provides: “An agreement for sale, option agreement, purchase agreement, commission receipt, or affidavit, which affidavit quotes or refers to an agreement for sale, lease option agreement, purchase agreement, commission receipt, or lease, and such instrument claims to or affects any interest in real property shall be executed and acknowledged by the party thereto who appears by such instrument to be the party whose real property is affected or alienated thereby before any such instrument can be recorded. In the matter of a trust deed, it is the Trust deed itself that is recorded not the note that evidences the debt.”

The person who executes or signs a document alienating or leasing his/her interest in real property is the one who makes the acknowledgment of his/her signature. An official “witness” is required, and this person takes the acknowledgment.

When a person cannot write, he/she may sign any instrument by mark, that is, by making a cross or other sign. If this execution is to be acknowledged, two witnesses must also sign. One witness must write the name of the person executing the instrument near his/her mark.

The Civil Code provides: The proof of acknowledgment of an instrument may be made in this state, within the county or city and county in which the officer was elected or appointed before either:

1. The Clerk of a Municipal or Justice Court.
2. A County Clerk.
3. A Court Commissioner.
4. A Notary Public.
5. A Judge of a Municipal or Justice Court.
6. A District Attorney.
7. A Clerk of a Board of Supervisors.

Section 8200 of the Government Code provides: “The Secretary of State may appoint and commission notaries public for the several counties of the state in such number as he/she deems necessary for the public convenience. Notaries public shall reside or have their principal place of business in the county where appointed, but they may act as such notaries in any part of the state, provided, however, that the name of the county for which the commission is issued shall be clearly indicated upon the document; they shall receive for their services such fees as are provided by law.”

Verification

A verification is an oath or affirmation made before a notary public or other qualified officer that the contents of an instrument are true. Certain instruments must be verified instead of simply acknowledged. Among these are notices of non responsibility, notices of completion, statements in filing mechanic’s liens, etc.

Affidavit

An affidavit is a statement or recital of circumstances made in writing to which a person takes an oath that they are true. For instance, a person may swear to an affidavit stating that he/she saw a certain person in a certain place at a specified time.

Affirmation

An affirmation is a solemn declaration made by a person whose religious beliefs prohibit him/her from taking an oath.

Title Insurance

The usual evidence of ownership of any interest in the title to real property is the document by which the interest was obtained. This document may be a deed, lease, contract, or judgment of the court. The general public, however, looks to the public records to find such evidence. Since it is impossible for the purchaser of property to personally inspect all of the instruments that may have been recorded, several ways have been developed to assure that the purchaser will receive a good and marketable title.

The instruments proving title are:

1. Abstract of Title
2. Certificate of Title
3. Guarantee of Title
4. Policy of Title Insurance

Abstract of Title

An **abstract of title** is a digest of all recorded instruments affecting title to the property and tracing that title back, in summary, from the last recorded deed or encumbrance to the patent or grant from the sovereign power. The instruments involved are called a “chain of title.” An abstract of title is basically a “title search.”

An abstract of title is a cumbersome method of proving title. In preparing an abstract of title, one would have to check all recordings back through these books to the original patent, listing each instrument which may have affected title. In splitting up large holdings into smaller ones and in the subdivision of city lots, numerous complications and complexities arise. An abstract then becomes both cumbersome and unsatisfactory. In some jurisdictions, the abstract of title method is still used. The abstract is usually prepared by a person who engages in this type of work and is known as an “abstractor,” and the opinion of an attorney who specializes in abstract work is added.

Certificate of Title

Certain abstractors and attorneys, and certain companies in many jurisdictions, issue what is termed a certificate of title. In this instrument, the abstractor and attorney, or the attorney alone, certifies that an abstract of title has been made or checked and that the title has been found to be a good and marketable title.

A certificate of title is an opinion of the person executing it, and does not carry with it any redress in case it is found faulty. A certificate of title is valued only in proportion to the reputation of the person issuing it.

Guarantee of Title

Certain companies conceived an idea of executing a guarantee of title based upon an abstract prepared by their abstractor or attorney. These companies, having financial responsibility, issue their written guarantee that a title is good and marketable. This guarantee is, of course, valuable only as the company issuing it has financial strength. To prevent irresponsible agencies from issuing worthless guarantees, some states have passed legislation requiring that such guarantees be backed by substantial worth.

Policy of Title Insurance

The name itself indicates that title insurance companies come under the jurisdiction of the Insurance Commissioner of the State of California. The wording of this law must be interpreted carefully. The Insurance Commissioner is granted regulatory powers over those licensed in the title insurance business. Title insurers are to compete for business with the public in this state under the regulatory authority of the Insurance Commissioner. They must submit schedules of their rate charges to the commissioner at least 30 days before new fee schedules go into effect.

An **abstract of title** covers only the record of title in county recorders' offices. Frequently, conditions arise whereby the chain of title, good on its face, is defective for some undisclosed reason. There may be a forged deed in the chain of title, or a deed lacking the essential of delivery, or some other essential regarding the identity of either the grantor or grantee, or there may be some other undisclosed defect which may nullify the chain of title, rendering an abstract of title, certificate of title, or a guarantee of title of no value.

Today, abstracts of title are replaced by policies of title insurance, largely in the standardized form prepared by the California Land Title Association (CLTA), which is the trade organization of the title companies of the state. Title insurance is the means employed in California by which sellers prove to buyers that they are in fact the owners of the property in the transaction at hand.

Title insurance procedures include the investigation of innumerable public records, and the issuance of an insurance protecting the insured against specified types of risks in the chain of title. It can be said, generally, that title insurance assures protection against most risks which are a matter of public record and against some non recorded risks, the number of the latter being dependent upon the type of policy ordered.

The county recorder's office provides the greatest number of records requiring investigation. Many other public records, however, also contain information on land titles. County clerks' offices, taxing agencies, federal and state courts, and the Secretary of State's office are other sources of public records. Many of these are duplicated and filed in a more convenient form in the title company's office.

Title Plant: Title insurance companies previously maintained a “plant” consisting of copies of all county recordings made each day which affect title to property. It is from this “Plant” that searches are made for title insurance. Title companies will “post” these recorded documents by legal description. In contrast, the county recorder will index recorded documents in alphabetical order.

Today two major companies perform this work. All title companies subscribe to one or the other of these companies thus reducing the expense and duplication necessary when hundreds of title insurance companies are in business.

A preliminary title report is usually issued at the beginning of the escrow period. This report will show any defects found in the chain of title and which need to be cleared prior to the transfer of title and the issuance of the final title insurance policy. The purpose is obvious. If clouds on the title need to be removed they should be found at the beginning of escrow and removed as a part of the escrow process.

Owner’s Standard Coverage Policy CLTA Policy

The most common type of title insurance policy is the CLTA. The risks normally insured against under this policy are the following:

1. Most matters disclosed by the public records
2. Lack of capacity of parties, such as minors and incompetents
3. Forgery in the chain of title
4. Lack of authority of parties, e.g., agents, corporations and fiduciaries
5. Lack of, or defective delivery of instruments of title
6. Cost of defending title, if necessary.

The risks not normally insured against under this policy are: matters not disclosed by public records; zoning, water and mineral rights, defects that are known to the insured at the time the policy is issued but not disclosed to the title company and defects that only a physical inspection of the property will reveal.

Extended Coverage Policy Lenders ALTA Policy (American Land Title Association)

To meet the demands of nonresident lenders who could not inspect the physical condition of the premises personally, the **ALTA** policy was devised. An ALTA policy generally covers anything requiring a physical inspection of the property. Encroachments would be a good example. It expands the risks normally insured against under the standard policy to include:

1. Unrecorded mechanics’ liens
2. Unrecorded physical easements
3. Acts a correct survey would show

4. Water and mineral rights;
5. Rights of parties in possession, such as tenants and buyers under unrecorded instruments
6. Cost of defending title, if necessary.

An Owner's Extended Coverage or "ALTA Owner's Policy" is issued to an owner of the fee title, and in addition to the coverage of Standard Coverage Policy, includes protection as to matters that would be discovered by making an inquiry of parties in possession, an inspection, or from an accurate survey of the property. This policy also affords coverage as to access, i.e., that the land is not land locked.

Risks not normally insured against under any type of policy are: zoning regulations, and defects known to the insured at the time the policy is issued, but not disclosed to the title company.

In many areas of California, it is now possible to obtain a "joint protection policy" in which the protection afforded to both the buyer and the lender are combined in one policy.

Franchising

Franchising is a marketing or distribution system under which a large business firm (**franchisor**) awards an exclusive dealership to a purchaser investor (**franchisee**). The franchisee privilege allows the franchisee to use the franchisor's trade name, trademark or service mark or other identifying symbol, products, equipment, services, and standardized products in the franchise outlet in the franchisee's individually owned business.

Franchising is seemingly a popular form of investment opportunity allowing investors to benefit from the expert management, assistance, special training, and the marketing and promotional know-how of the franchisor while being self-employed. Today hundreds of companies use franchise outlets. They include automobile dealerships, food service operations, hotels and motels, convenience foods and drug stores, to name a few. However, there are many risks to consider in purchasing a franchise. Many ill conceived, inefficient, non-competitive franchisors have failed for each one who has been successful.

Prior to the enactment of the Franchise Investment Law, the sale of franchises in this state was regulated only to the limited extent to which the Corporate Securities Law of 1968 applied to such transactions. The widespread sale of franchises created numerous problems both from an investment and a business point of view which led to the passage of the law.

The Franchise Investment Law exempts from registering the offer and sale of a franchise, if the franchiser:

1. Has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than five million dollars.
2. Has a net worth, according to its most recent audited financial statement, of not less than one million dollars and is at least 80% owned by a corporation which has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than five million dollars.

Another exemption in the Corporations Code provides that the offer or sale of a franchise by a franchisee for his/her own account or the offer or sale of the entire area franchise owned by a sub-franchisor for his/her own account is exempted from the requirements of the Franchise Investment Law.

Essentially, it is a modified disclosure law designed to provide a prospective purchaser with full and adequate disclosure of all material terms of the franchise agreement. These disclosures will be contained in an offering prospectus which must be delivered to a prospective purchaser at least 10 business days prior to the effect of any binding franchise agreement or at least 10 business days before the receipt of any consideration, whichever occurs first.

This law provides that unless specifically exempted, every franchisor who sells a franchise must meet disclosure provisions.

The intent of the law is to compel a franchisor to furnish a prospective franchisee with sufficient information to enable the franchisee to make an intelligent decision on or about the franchise offered; against fraud or a likelihood that the franchisor's promises would not be fulfilled; and, to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship.

There are three separate and distinct categories of persons authorized to sell nonexempt franchises. They are:

1. A person identified in an application registered with the Commissioner of Corporations for an offering of a franchise in California.
2. A person licensed by the California Department of Real Estate as a real estate broker or a real estate salesperson.
3. A person licensed by the Commissioner of Corporations as a broker dealer or agent under the Corporate Securities Law of 1968.

Thus, a real estate broker, real estate salesperson, broker dealer or agent can sell franchise interests without being identified in the registration application, while a person identified in the registration application can sell the franchise interest even though not licensed as a real estate broker, real estate salesperson, broker dealer or agent.

It should be noted that the franchisee may sell his/her own business unless the franchisee's agreement has restrictions as to this activity.

Franchising is a form of business activity which can be fraught with many problems. This presents a challenge to any licensee who plans to become a specialist in this field. Certainly before becoming involved in franchising, the licensee should possess a professional knowledge of the entire system and be familiar with the type of problems likely to be encountered by an owner of a franchise business.

The full text of the Franchise Investment Law may be found in the Corporations Code, Section 3, Division 5, (Title 4).

Business Opportunities

Under this heading there are three areas.

1. Licenses
2. Uniform Commercial Code
3. Alcoholic Beverage Control Act

Licenses

Real Estate and business opportunity licenses are merged by statute. A real estate license is required for anyone to engage in the sale of business opportunities. The special classification of business opportunity license no longer exists. Candidates for a real estate license are now examined to some extent on business opportunity practice and, upon licensure, may legally negotiate the sale of business opportunities.

Business Opportunity

The Real Estate Law defines “business opportunity” as meaning and including business, business opportunity and goodwill of an existing or proposed business venture or any combination for these possibilities.

From a study published under the auspices of the Department of Real Estate, we learn that it could take:

- 1,000 families to support an appliance store
- 1,100 families to support a liquor store
- 300 families to support a restaurant
- 1,900 families to support a shoe store

It is therefore important that a neighborhood survey be taken before the election to open a business within a given community.

The sale of a business opportunity involves the sale of personal property and the rules and laws governing transfer of chattels apply. The usual transactions involve such going businesses as grocery stores, drug stores, gasoline service stations, restaurants, beverage shops or bars, bakeries, garages, leases and fixtures for operating rooming houses and hotels, etc. The sale of such businesses almost always includes the stock, fixtures, equipment and good will.

Handling Business Opportunity Transactions

A business opportunities broker is a real estate broker licensee who deals in transactions which involve small businesses rather than real estate.

Such a broker should never lose sight of the fact that the seller is actually employing him/her to sell their business. In most cases, he/she as a broker, also has a great responsibility to potential buyers who often are investing their life savings and should be given a fair chance to succeed. Unlike real property which always retains some value, a defunct business has little

or no value, and a subsequent business failure can only reflect adversely upon the selling broker. Therefore, listings should be taken with great care and where reasonable value is not represented, the listing should be turned down.

In smaller sales where everything, including stock, is going to be sold at a given price, it is good practice to include in the listing a guaranteed inventory to assure the buyer that he/she is getting dollars and cents value in merchandise. Upon consummation of the sale, a physical inventory may be taken, and should the figure fall below that represented, an adjustment in the purchase price may be made.

The purchase may include the rehiring of existing employees. The broker should be aware that if several employees have not received their vacations, the closing should ensure that this item is the seller's expense, to be handled personally or in the closing.

Another important phase of listing property is to inform the seller that his/her books are to be opened to the potential buyer after a deposit has been taken. Since it is nearly impossible for the broker to verify listing figures given by the seller, the broker should emphasize that preliminary figures quoted while selling the business will ultimately be checked by the prospective buyer.

After the prospective purchaser has indicated a willingness to buy, it is excellent practice to incorporate several contingencies in the purchase agreement protecting him/her and the broker, covering representations made to him/her. These vary with each transaction, but following are some typical examples.

1. Amount of rent
2. Length of lease
3. Terms and conditions of lease
4. The seller's ability to transfer the lease to the buyer
5. Approval of the inventory
6. Approval of the business records
7. Transfer of various licenses
8. Securing a permit to operate

A prudent course for a broker to follow is to help with all physical inventories taken and to have both the buyer and the seller sign their approval of the same. Other items which should be understood and taken care of by the broker are the bill of sale, the escrow agreement and instructions, pro-rations of insurance, rents, accounts receivable, taxes and licenses.

The eleven important steps in closing a business opportunity sale, beginning at the time the buyer is ready to purchase until the sale is completed, are:

1. Have the buyer sign the offer to purchase agreement.
2. Have the seller accept buyers agreement.
3. Escrow the entire transaction.
4. Record the notice of intention to sell.
5. Advertise the sale to comply with the twelve-day escrow law.
6. Deliver or mail a copy of notice of sale to county tax collector.
7. Inventory all personal property.
8. Issue the bill of sale which must include everything.
9. Have the lease transferred to buyer.
10. See that all sales taxes are paid and a clearance receipt is issued.
11. Give seller and buyer complete closing statements covering all money and/or property transferred in the transaction.

Transfer of Title

The **bill of sale** is to chattels what the deed is to real estate. It is the instrument or document used to certify the transfer of title to personal property. Just as it is important to have a good description in a deed, it is important to describe accurately the property being conveyed by a bill of sale. Most personal property is delivered to the new owner along with the bill of sale to evidence the new ownership. No provision is made in the law to record a bill of sale to give constructive notice, as with a deed, and some counties refuse to record them. Others will, upon request, accept them “for the record” with or without an acknowledgment by the seller. From person to person, most personal property is sold without anything written. The sale is legal but difficult to prove.

The seller who gives the bill of sale is called the **vendor** and the buyer is the **vendee**. Other terms used in this context would be, transferor/transferee (seller/buyer); you should also be prepared for payor/payee (buyer/seller). Failure to recognize these various relationships can be confusing for the student. When the bill of sale is intended to transfer title to a group of items, such as the furniture and fixtures in a store, it is important to take an accurate inventory to be included in the bill of sale. Real estate brokers and salespersons should learn to take accurate inventories.

Of importance to real estate licensees are the requirements of Division 6 of the Uniform Commercial Code pertaining to bulk transfers of goods in this State. The broker who handles the sale of a business should see that the seller and buyer observe these statutory provisions designed to warn the transferor’s creditors of the impending transfer so they may obtain payment of their claims, or protect their rights before the assets are disposed of or encumbered. Recordation and publication achieve this purpose.

Applications of Division 6

When a retail or wholesale merchant, (e.g., a baker, or the owner of a cafe or restaurant, garage, or of a cleaning service), desires to transfer the transferor's business including a substantial part of his/her material, supplies, merchandise, or other inventory, Division 6 applies. Regulations of Division 6 requires the transferee to give public notice to the transferor's creditors by:

1. Recordation of a notice of intended sale in the office of the county recorder (of the county or counties in which the property to be transferred is located) at least 12 business days before the bulk transfer is to be consummated, or the sale, if by auction is to commence.
2. Publication of the notice at least once in a newspaper of general circulation published in the judicial district in which the property is located, or if there is none, then in a newspaper of general circulation in the county in which the business is located. Notice must be published at least 12 business days before the bulk transfer.
3. Personally deliver or send by registered or certified mail at least 12 business days before the bulk sale is to be consummated, or the sale by auction is to be commenced, a copy of the notice to the county tax collector in the county or counties in which the property to be transferred is located.

The notice must contain the following information:

- ▢ Information that a bulk transfer is to be made.
- ▢ Names and business addresses of transferor, and all other business names and addresses used by the transferor within the past three years as far as known to the transferee.
- ▢ Location and general description of the property to be transferred.
- ▢ Place and date, on or after which the bulk transfer is to be consummated, or auction commenced. Also name and address of person with whom claims may be filed and the last date for filing claims.

Note: This list did not include the purchase price of the business or the purchaser's name.

Effect of Non-Compliance

When compliance is necessary but the statutory filing and publication requirements are not met, the result is to render the transfer valid as between buyer and seller but fraudulent and void against those creditors of the transferor who hold claims based on transactions or events occurring before the bulk transfer. This would make the buyer liable for these obligations.

In an auction sale, the responsibility for giving the statutory notice is the auctioneer's. An auction sale which does not comply with the statutory requirements does not render the transfer fraudulent and void, but the auctioneer becomes personally liable to the transferor's creditors for the sums owed to them by the debtor, not exceeding the reasonable value of the assets sold.

Uniform Commercial Code

When personal property is made security for a loan under a chattel mortgage or **Security Agreement**, it is said to be “hypothecated”, i.e., given as security without relinquishing actual possession. When title is transferred to another person it is “alienated.”

Often, personal property is delivered as security for a loan. Such an agreement is called a bailment. It is a contract where personal property is delivered by one party to another, held for a purpose, and later returned (such as a pawnbroker).

Although a written agreement is not necessary when collateral (personal property security) is in the possession of the secured party as in a pledge (and there are other exceptions), in all other cases a security interest is not enforceable unless there is a written security agreement signed by the debtor which describes the collateral. Sometimes a compensating balance is given to the lender. This sum of money on deposit with the lender is an income to compensate them for making the loan.

In contrast to the trust deed or mortgage with which real property is made security for an obligation (debt), a security agreement is the instrument commonly used to create a security interest in personal property. To protect or “perfect” the interest created by the security agreement against other security interests and/or lien creditors or subsequent purchasers, a financing statement must be filed in connection with personal property security transactions.

It is the security agreement which creates the security interest of the secured party. The financing statement is no substitute for the security agreement because it does not contain the necessary grant of the security interest, although it gives other basic information concerning the security agreement.

The financing statement (form **UCC-1**) is ordinarily filed with the Secretary of State’s office in Sacramento. The filing will take place at the county recorder’s office in the county of the debtor’s residence on transactions involving some consumer goods, farm equipment, farm crops growing or to be grown, timber to be cut or minerals and the like (including oil and gas) with limited exceptions, e.g., goods if they are primarily used for personal, family or household purposes.

Extension & Termination

Once it is filed, the financing statement is effective for five years from the date of filing and will lapse upon the expiration of that period. To have the filing extended beyond the five-year period, the secured party must file a continuation statement any time within the six month period preceding the expiration of the five-year period. Succeeding continuation statements may be filed later in the same manner to continue the effectiveness of the original financing statement.

Generally, there are two forms available for use in such transactions. The usual filing is accomplished, as we said, by filing the financing statement (form UCC 1) in the appropriate location. There is another form which has multiple uses (form UCC 2). This form is used as a Continuation Statement, a Termination Statement, a Release Statement or an Amendment

Statement, whatever the need may be. The person filing the form would identify the appropriate use in each specific case.



Alcoholic Control Act

The Department of Alcoholic Beverage Control is charged with administration of the Alcoholic Beverage Control Act and issues licenses as the law provides. It also has the power, for good cause, to deny, suspend or revoke any specific alcoholic beverage license. Local officials and the Department are charged with the duty of enforcing the law.

Alcoholic beverage licenses are issued to qualified adult persons, partnerships, fiduciaries and corporations for use at particular premises which have been approved by the Department. The applicant must be of good moral character. A complete background disclosure and fingerprinting is required of each applicant and corporation official. The Department may deny the license if there is an attempt to conceal any arrest record.

An on-sale general license and an on-sale general license for seasonal business may now be issued to aliens or to a corporation in which an alien holds the controlling interest. The premises may be disapproved if it's in the immediate vicinity of a school, church, public playground or other consideration point. The premises may be disapproved for various other reasons, including an over concentration of alcoholic beverage licenses in the area, the creation of a police problem, or delinquent tax payments on the part of the transferor.

Law and Business Regulations

It should be obvious that an agent negotiating a business opportunity transaction involving the transfer of such a license must be familiar with these statutes and regulations in their entirety. They are available through any office of the Department of Alcoholic Beverage Control and contain the schedule of license fees.

Speculation in licenses is condemned by the Department and it may file a complaint against any broker who participates in such speculation or violation of law in connection with the transfer of a license. Licenses may not be purchased by a broker at a bankruptcy or trustee's sale with the expectation of transfer to a nominee. The only person who may have an interest in an alcoholic beverage license is the person who is operating or intends to operate the licensed business. The Department may file a complaint against any broker who participates in the sale of a license against which disciplinary action is pending if he/she fails to determine such fact and advise the purchaser of that disciplinary action.

Excerpts from Alcoholic Beverage Control Act

Original on sale and off sale fee: An applicant for an original on sale general license shall, at the time of filing the application for the license, accompany the application with the required fee. At the time of filing an application for a license, an applicant for an original on sale general license for seasonal business shall accompany the application with the required fee.

Person and location: Each license shall be issued to a specific person and shall be issued for a specific location, the principal address of which shall be indicated on the license.

Each license is separate and distinct and is transferable, upon approval by the Department, from the licensee to another person and from one location to another location. All retail licenses may be transferred from one county to another county, except that the number of on sale general licenses and off sale general licenses in existence in any county on June 1st of any year shall not be increased by more than 5% by such transfers or by more than 10% by any combination of transfers.

No numerically limited retail license, or on sale general license for seasonal business, may be transferred without the prior filing of a notice of intention with the county recorder of the county. A certified copy of the notice of intention, together with a transfer application, must then be filed with the Department of Alcoholic Beverage Control.

If the intended transfer of either the business or the license involves a consideration, the licensee and transferee must establish an escrow with a neutral holder, and deposit therewith the full amount of consideration. An agreement signed by the licensee (seller) and the intended purchaser must be deposited with the escrow holder. This agreement will direct the escrow holder, after certain requirements are satisfied, to pay out of the purchase price the claims of bonfire creditors of the licensee (seller) who file their claims with the escrow holder before the escrow holder is notified of the Department's approval of the transfer of the licensee. If the funds are insufficient to cover the full amount of all claims, a pro rata distribution must be made.

No licensee shall enter into an agreement pledging the transfer of his/her license as security for either a loan or the fulfillment of any agreement. Each transfer application shall be accompanied by a mutually verified statement to this effect.

Purchase and sale price: The consideration that may be paid or received for an on sale or off sale general license depends upon the number of years that have elapsed since the license was originally issued. During the first five years of the license life, the amount shall not exceed the original amount paid to the state. After five years, there is no limit as to the amount for which it may be sold.

Fingerprinting of licensees: Every licensee and the officers of every corporate licensee shall have their fingerprints taken by the Department if they have management responsibilities and have not previously been fingerprinted.

Every person who applies for a license and the managing officers of a corporate applicant shall have their fingerprints taken by the Department at the time of filing an application for a license.

Applications by Married Persons

When an application is made by a married woman who is not separated from her husband, the husband of such person shall have his/her fingerprints taken by the Department in all cases, except where his/her absence from the State makes it impossible to do so. When an application is made by a married man, the wife of such person shall have her fingerprints taken by the Department if she is to work on or in the licensed premises or is to work in any way in the operation of the licensed business.

Additional Provisions Condensed

All licenses must be issued to specific persons at specific locations and when received must be signed by the holder and posted in a conspicuous place on the premises.

On sale general licenses will be issued to public premises, bona fide public eating places, and to a bona fide club providing such club has at least 100 members; has been in existence for at least 1 year; and is a nonprofit organization. On sale general licenses may also be issued to seasonal resort locations, clubs, boats, airplanes and trains.

On sale licenses are issued on a calendar year basis (January to January); off sale licenses are issued on a fiscal year basis (July to July).

In the case of each application for an original license or transfer of a license, a Notice of Intention to apply for the license, must be posted conspicuously at the entrance of the premises for 30 days prior to issuance of the license.

A license will not be issued, transferred, nor renewed if the person or persons in interest are delinquent in their obligations under the sales tax law. The Department may refuse to issue licenses for locations where on sale liquor, beer or wine is proposed to be sold near churches, schools, hospitals and playgrounds. Zoning restrictions are recognized in issuing such licenses.

Any license may be denied to a person who has been convicted of a felony. A licensee may not pledge to transfer his/her license as security for a loan.

Business Opportunity Accounting

Balance sheet: A statement showing the financial condition of a business and lists the firm's assets, liabilities and net worth as of a given date.

Assets: Things of value owned by the firm, personal property, prepaid expenses.

Liabilities: The debts or expenses still owing or unpaid, i.e., accounts and notes payable, accrued expenses.

Net worth: The difference between the firm's assets and liabilities which represents the owner's equity.

Accounts payable: A running record of business transactions showing the amounts of money owed. They are considered as liabilities.

Accounts receivable: Amounts of money remaining unpaid to the seller of stock in trade in the ordinary course of business. They are considered as assets.

The **income statement** (profit and loss statement) is often called “P & L” statement. It shows the net gain or net loss incurred by a firm for a given period of time. It lists the sources and amounts of revenue and expenses for the period. Very briefly, this statement would identify the gross income of a business venture. Income may result from sales, rents, dividends, and interest income. From this gross income, the expenses are deducted which would leave the operator with a profit or a loss. Business owners, potential buyers, and lenders pay greater attention to the net income (profit) of the business than they do to the gross income in determining the worth of a business venture.

Liquidity: Liabilities less cash on hand. Equals liquid assets. This is a test of the ability of a merchant to obtain a loan. Another test of the worthiness of a business is:

Current ratio: This is determined by dividing current assets by current liabilities, current assets being defined as cash, everything due and collectable within one year. A generally acceptable ratio is 2 to 1, that is \$2.00 in current assets for each \$1.00 of current liabilities.

Expense accounts: The amounts expended or paid for various services or goods used during the year. These would include utilities, wages, advertising, cost of goods sold, etc.

A depreciation reserve is used to provide protection for invested capital. It would show that the venture not only produces return on investment (income) but in addition a return of the initial investment. This would be an asset.

The specific items shown below were taken from a firm’s books and indicate the total accumulated figures after the year ending December 31, 1998. The items are identified as follows: (A) Assets, (L) Liabilities, (I) Income, (C) Cost, and (E) Expenses. These identifications will not be shown in examination circumstances. You will note that **goodwill** is not listed because it is not a tangible item the value of which cannot be ascertained outside of the above asset price a willing buyer will pay for a business.

(A) Cash on hand	\$50,000
(C) Wholesale cost of goods sold	100,000
(E) Annual license fees	1,000
(E) Property taxes paid	2,000
(E) Miscellaneous expenses	1,800
(E) Maintenance expenses	500
(L) Notes payable	50,000
(E) Annual rent	19,250
(A) Accounts receivable	150,000
(A) Security deposit – lease	500

(A) Office equipment	50,000
(A) Store fixtures	150,000
(E) Freight & trucking exp.	2,000
(I) Total sales - 1987	350,000
(E) Annual wages & salaries	30,000
(L) Accounts payable	100,000
(A) Prepaid insurance	5,000
(A) Inventory as of 12/31/81	325,000
(E) Utilities expense	6,000
(E) Annual depreciation equip.	5,000
(A) Reserve for depreciation	20,000

Questions:

1. What is the net worth of the business? (Assets minus liabilities)

Answer: Total assets \$750,500 minus liabilities \$150,000 leaves \$600,500 (A L)

2. What was the annual gross profit? (Gross sales minus cost of goods)

Answer: Gross sales \$350,000 less cost of goods \$100,000 leaves \$250,000 (I C)

3. What was the annual net profit? Gross sales less expenses and cost of goods.

Answer: Sales \$350,000 minus cost \$167,550 & operating expense leaves \$182,450 (I C E)

Notice of Intended Sale

After a sales contract has been entered into on a business, the next step is to put the transaction in escrow. Many brokers specializing in business sales handle their own escrows, which has its advantages and disadvantages.

Twelve business days before the bulk transfer is to be consummated or the sale by auction is to be commenced, the **Notice to Creditors of Bulk Transfer** must be:

- Recorded in the county recorder's office in which the property is located
- Published in a newspaper of general circulation in the judicial district in which the property is located
- Personally delivered or sent by registered or certified mail to the county tax collector of the county or counties in which the property to be transferred is located.

The above actions are required by law or the new owner can become responsible for any unpaid accounts of the old owner. Although it is the seller's responsibility to have the notice published, it is the duty of the broker to protect the buyer from any such **successor's liability**. Failure to accomplish the above does not void the sale, it does place a cloud on the rights of the buyers.



Notice To Creditors of Bulk Transfer:
<http://lumbleau.com/notice-creditors-bulk-transfer>



Bill of Sale

After satisfying all the legal requirements in a business escrow and no creditors have filed claims against the business, you are ready to transfer title. As a business is personal property, this is accomplished with a bill of sale. Make sure that the description is detailed and attach an inventory of the stock and fixtures which the buyer and seller have agreed upon.

A typical description used in a bill of sale is as follows:

“All the stock, fixtures and goodwill of that certain business known as Don’s Grocery, located at 1122 Elm Street, City of Fresno, County of Fresno, State of California. Inventory of stock and fixtures is attached and made apart hereof.” (it is also good practice to note in this same space “This sale is subject to the provisions of the Uniform Commercial Code.”)



Bill of Sale:
<http://lumbleau.com/bill-of-sale>



Chapter 12 Summary

Property used in a trade or a business is said to be a section 1031 asset, and consequently receives more favorable treatment. If you trade investment or business property for other investment or business property of a like-kind you postpone tax on the gain or postpone deduction of the loss until you dispose of the property you receive in the exchange. This is commonly referred to as a **tax-free exchange**.

Once the **cost basis** is established, certain adjustments can be made to it before gain or loss on sale can be determined, known as the **adjusted basis** of the property. Basis must be increased by the cost of any permanent improvements to the property, such as: adding a room, installing a new roof, paving a driveway or installing a swimming pool.

Certain personal property is exempt from taxation, such as that which is used by public service, by privately owned non profit organizations, household furnishings and personal effects, shares of stock and promissory notes.

The **Documentary Transfer Tax Act** allows cities and counties to adopt a tax known as a transfer tax on the conveyance of title to property with some exceptions. The levy is .55 cents per \$500 or any fraction of \$500. This would be the same as \$1.10 per \$1000.

Upon the sale of any business holding a sales tax permit, it is necessary to pay a sales tax on the furniture, fixtures, and equipment sold. Usually, it is necessary to get a final clearance form from the **State Board of Equalization** to close the escrow.

Recording of an instrument imparts **constructive notice**. Instruments affecting real property must be recorded in the county in which the property is located to give such notice.

The instruments themselves may be valid in the order in which they were executed, the recording system of California provides that an instrument executed first in time may not take precedence over subsequent claimants if the subsequent parties have acted in good faith, for a valuable consideration, and recorded their interest first. It would seem, therefore, that the general rule of priority might be that those first to record are first in right. Although it may be said that this is the general rule, there are four important exceptions: 1. Taxes and assessments, 2. Mechanics' Liens, 3. Agreements, and 4. Actual Notice.

An **acknowledgment** is a declaration that a person has executed an instrument and that it is done of his/her own free will.

An **affidavit** is a statement or recital of circumstances made in writing to which a person takes an oath that they are true. For instance, a person may swear to an affidavit stating that he/she saw a certain person in a certain place at a specified time.

Title insurance procedures include the investigation of innumerable public records in the chain of title. The county recorder's office provides the greatest number of records requiring investigation. Many other public records, however, also contain data bearing upon land titles. County clerks' offices, taxing agencies, federal and state courts, and the Secretary of State's office are some of these other public records.

The most common type of title insurance policy is the **C.L.T.A.** The risks normally insured against under this policy are:

1. Most matters disclosed by the public records
2. Lack of capacity of parties, such as minors and incompetents
3. Forgery in the chain of title
4. Lack of authority of parties, e.g., agents, corporations and fiduciaries
5. Lack of, or defective delivery of instruments of title
6. Cost of defending title, if necessary

An Owner's Extended Coverage or **ALTA Owner's Policy** is issued to an owner of the fee title. In addition to the coverage of Standard Coverage Policy, an ALTA Owner's Policy includes protection as to matters that would be discovered by making an inquiry of parties in possession, an inspection, or from an accurate survey of the property.

Franchising is a marketing or distribution system under which a large business firm (**franchisor**) awards an exclusive dealership to a purchaser investor (**franchisee**).

The **bill of sale** is to chattels what the deed is to real estate. It is the instrument or document used to certify the transfer of title to personal property.

When personal property is made security for a loan under a chattel mortgage or **Security Agreement**, it is said to be **hypothecated**, i.e., given as security without relinquishing actual possession. When title is transferred to another person it is **alienated**.

The **Department of Alcoholic Beverage Control** is charged with administration of the Alcoholic Beverage Control Act and issues licenses as the law provides.

notes:

chapter 12 quiz

- 1. It often happens that the lessee prepays one month's rent at the outset of his/her lease period. In normal accounting procedures, the prepaid rent is treated as:**
 - a. Accrued income for the lessor.
 - b. Accrued expenses for the lessee.
 - c. Deferred income of the lessor.
 - d. Deferred income for the lessee.
- 2. In a cash operating statement, taxes and fire insurance premiums would be identified as:**
 - a. Operating expenses.
 - b. Capital expenses.
 - c. Fixed expenses.
 - d. Other expenses.
- 3. Should an owner taxpayer sell residential property at a loss, he/she could report the loss on his/her federal income tax return:**
 - a. If it was used as a business property but only if there was a profit realized in the year of sale.
 - b. If it is used as rental income property.
 - c. If it is used as the taxpayer's residence.
 - d. If the taxpayer had capitalized the property taxes.
- 4. Depreciation has which of the following effects?**
 - a. Increases value.
 - b. Decreases cost basis.
 - c. Creates a lien.
 - d. None of the above.
- 5. When Walter adds a swimming pool to an apartment property, it has the following effect on his income taxes:**
 - a. He may deduct the cost of the pool as an expense.
 - b. He will get a credit to offset a portion of the rental income.
 - c. He will increase his basis in the property.
 - d. It will have no effect on his taxes.
- 6. The owner of an unimproved parcel of real estate, held for investment purposes, may deduct the following item in preparing her federal income tax return:**
 - a. A loss suffered in the sale of the property
 - b. Carrying charges, if capitalized.
 - c. An allowance for annual depreciation
 - d. Any of the above.
- 7. When filing his/her federal income tax return, the owner of a condominium in which he/she resides may take a deduction for his/her portion of:**
 - a. The interest payments for the mortgage on the common areas.
 - b. The maintenance expenses for the common areas.
 - c. The repairs to his/her individual unit.
 - d. All of the above may be deducted.
- 8. Harley enters into an agreement to exchange investment real estate he owns with a fair market value of \$330,000 and an adjusted basis of \$220,000. He is exchanging this property for an investment property with a fair market value of \$360,000. Both properties were owned free and clear and no boot is given or received by either party. Harley's basis on his new property would be:**
 - a. \$110,000
 - b. \$140,000
 - c. \$220,000
 - d. \$330,000
- 9. Which of the following is an expense or cost to a homeowner?**
 - a. Interest lost on equity investment in the home.
 - b. Reduction in the value to the lot.
 - c. Appreciation due to painting.
 - d. Increase in amenities.
- 10. Ad valorem most nearly means:**
 - a. The price at which a property could be expected to sell when it has been on the market for a reasonable period of time.
 - b. Income taxes.
 - c. According to value.
 - d. None of the above.



“It’s not so much about chasing a commission on a one-time deal as keeping a happy client for lifetime.”

– Madison Hildebrand

CHAPTER 13: *financing*

Learning Objectives

Real estate loans are needed in almost every transaction. This chapter itemizes the many sources of real estate financing and the financing terms used in the industry. Many lenders specialize in owner-occupied homes and others deal only in investment properties. Also explained are the sources of money used to fund and insure these lenders.

key terms

Amortization	Fannie Mae	Open Market Operations
Balloon Payment	Federal Reserve Act	Package Trust Deed
Buyer's Market	Federal Reserve Bank System	Point
CalVet	Financial Disintermediation	Primary Mortgage Market
Conditional Commitment	Firm Commitment	Prime Rate
Contract of Sale	Freddie Mac	Purchase Money
Conventional Financing	Ginnie Mae	Seasoned Loan
CRV	Institutional Lenders	Secondary Mortgage Market
Debt Income Ratio	Mortgage Loan Broker	Seller's Market
Discount Points	Negative Amortization	Service Debt
Discount Rate	Non institutional Lenders	Straight Loans
Equity loans		

Financing Real Estate Purchases

In the realm of real estate financing comparisons are often made between the many kinds of property used as security for loans. When comparing a lender's attitude in making a loan on an apartment or on a motel, interest rates often run 1 to 2 percent higher than a house. Office buildings may even be higher. Commercial lenders typically lend only 50% of the appraised value. There is greater competition for motel loans because of nationwide and regional chains of motels that have been established and the large supply of land upon which to erect the establishments. It can readily be shown that interest rates charged on the financing of extensive commercial property ventures, such as office buildings and shopping centers, are usually lower than that charged in other real estate ventures even though they are sometimes subject to great risk. The advantage to the institution making this type of loan is the reduced cost of establishing and servicing the loan which may produce a higher than average yield over the term of the loan. For the balance of this lesson we will be dealing with interest rates as they affect the average real estate agent in residential property loans.

Understand that if everyone had to pay cash to purchase a home, there would be little home ownership. Financing is essential to purchasing a home on a “pay as you go” purchase plan rather than “outright” home ownership. There are many good reasons other than the simple fact that homebuyers don’t have the savings to pay cash. Some are:

- ▣ Savings remain as more liquid assets for use in sudden or emergency needs.
- ▣ Mortgage amortization payments constitute a regular and consistent form of savings in the form of increased equity.
- ▣ A home can be more readily sold, if the need arises, if it is subject to mortgage debt and if it is currently financed at available low rates of interest. The only advantage to 100% equity ownership is the use of the spendable monthly cash that would otherwise be used to make loan payments.

Studying this subject might lead you to the conclusion that real estate lending can be an unusually complicated and technical process. There is little difference in borrowing fifty cents for a candy bar and borrowing five hundred thousand dollars for the purchase of a residence. Obviously, the home loan involves more paperwork and more prescribed ritual because it involves a loan of a much greater amount of money. In its simplest form a secured real property loan, most often referred to as the “mortgage,” consists of a note which is evidence of the debt and the security for the note (deed of trust). The deed of trust, when recorded, creates a voluntary lien against the property.

Equity

Equity is the difference between mortgage indebtedness and market value of the property. Should the value of the property increase during the holding period the amount of the equity will increase. The reverse is also true as most California homeowners realized during downturns in the real estate market. As the value of property decreases, and the loan remains the same, the amount of equity will decrease. At any time during the holding period should the owner decide to pay off part of the loan, the consequence would be an increase in equity. Conversely, should an owner borrow more money on their property by taking out an equity loan, their equity in the property would decrease.

If a person borrows fifty cents from his/her friend, he/she would not expect the friend to require the borrower to sign any document admitting the debt. But if the loan were for fifty dollars (\$50) the borrower might possibly be asked to sign some type of “IOU.” Should the loan be for five hundred dollars (\$500), the lender might require a more formal promissory note from the borrower. It should not be surprising if the loan is for fifty thousand dollars (\$50,000), the lender would require the borrower to give not only a promissory note but also a deed of trust on property owned by the borrower as security. It is only natural that as the debt increases in amount, lenders will insist upon evidence of security to assure themselves that they can and will be able to recover the money advanced to the borrower.

The larger the equity position a borrower has in a property, the more secure will be the lender's position and the lower will be the interest charged by the lender. This is stated as the loan-to-value ratio. The lower the loan-to-value ratio, the larger the owner's equity. The higher the loan to value, the smaller the owner's equity.

Insurance companies that are in the business of making real estate loans offer the lowest loan to-value ratio on industrial real estate. In the highly specialized use of an industrial property, lenders are normally most cautious in making loans. In general, lenders give the lowest loan-to-value consideration to the property itself. More consideration is given to the profitability of the industrial venture.

Most buyers want a low-down payment and a large loan-to-value ratio because:

- ▣ The buyer does not have to liquidate his/her savings account and make a fixed investment.
- ▣ The amortized payments are a good form of forced savings.
- ▣ If the value of the home goes up, he/she will profit from the increase by a higher valuation of property.
- ▣ The loan-to-value ratio makes a subsequent loan assumption more desirable.

Though these advantages occur, the opposite also occurs. In liberalizing loan terms, the lender makes it possible for the borrowers with lower incomes to be able to borrow money. In the long run, however, the loan costs will be higher because more total interest will be paid. Because of this, low down payments make home ownership costlier.

Lenders, on the other hand, want as much security as possible for every loan. To find this security they:

- ▣ Look for a large down payment (high equity). The borrower is the first to lose money in a loan transaction. The higher the borrower's equity in the property, the larger the loan-to-value ratio, the better the security. Lenders also feel that a substantial equity tends to foster greater pride in ownership.
- ▣ Look to the borrower's ability to pay the monthly payments. A borrower's high income with low other expenses increases the borrower's ability to add security.
- ▣ Look to the guarantees given by the federal government through VA, FHA, Freddie Mac, Fanny May, and Ginny May secondary markets.

The liquidity of a borrower is his/her ability to pay off current bills. Current assets to current liabilities would be the test he/she would use.

Real estate lending is a long-term venture. The present condition of the economy will generally have little effect upon what will be the case five or ten years from now.

The process of determining the borrower's ability to repay the debt is referred to as a "loan or mortgage evaluation."

In the case of industrial property, because of the relatively large supply of land suitable for industrial use and because of buildings already in existence, loans on industrial properties are made primarily on the basis of the financial strength of the industrial user, not the estimated value of the land and improvements.

The interest rate agreed upon and named in the loan (nominal rate) depends, to a degree, upon these factors.

The need that the borrower has for the money is of little or no significance in the determination of the borrower's ability to repay the loan.

The federal government has determined that easing real estate lending would have a significant influence upon society by increasing home ownership. The government and its agencies are inclined to initiate programs designed to assist borrowers to obtain money needed to attain those purposes. The ideas and laws discussed in this section utilized in real estate lending largely because so much is at stake in this kind of activity.

Mortgage Markets

Broadly speaking, mortgage markets are classified as primary and secondary markets. (It might be noted here that the word "mortgage" is a customary term used throughout the country to indicate a financial obligation secured by real property). California is one of the states in which trust deeds are used almost exclusively for this purpose. So, "mortgage markets" include "trust deed" markets.

The **primary mortgage market** is made up of all lenders who supply funds directly to borrowers and carry the risks associated with long-term financing.

A **secondary mortgage market** is one in which existing mortgage loans or trust deed loans are bought, sold, or borrowed against.

Primary financing: An expression used to indicate the first or "prime" loan on a property, such as a first trust deed. At this point, the value of the property is of prime consideration because the "prime" lender must have a certified appraisal if the loan is to be sold.

Secondary financing: The term used to refer to loans that are subordinate to a first loan (i.e., second trust deeds, third trust deeds, etc.). Secondary financing is always involved with the homeowner's equity in the property. The higher the amount of equity, the greater will be the ability to obtain secondary financing. Most secondary financing comes from hard money **equity loans** and from sellers taking back a loan to assist the purchaser by lowering the down payment.

Today, practically all residential real estate loans made by institutional lenders are fully amortized loans, which means that the loans are repaid in equal or level installments of principal (and interest) over the term of the loan. Understand that the terms to amortize or **amortization** is to repay (liquidate) debt or obligation on the installment plan. It has nothing to do with the security device used to protect the lender. The interest is payable after the period during which the money was used. Interest is paid in arrears. The principle payments increase each month as the interest payment is reduced because interest is always paid on the remaining balance of the loan.

Service debt (debt service) is the amount of the monthly mortgage payment. If the monthly payment is not sufficient to cover the interest amount of the loan, the non paid interest will be added to the principal amount of the loan. This will increase the principal amount of the loan and is referred to as **negative amortization**.

You should also recognize that in addition to fully amortized loans, partiality amortized loans are used a great deal in real estate. In a partially amortized loan agreement, there will be a final payment which is larger than any of the other installment payments which must be paid to clear the debt. This final, larger payment is most often referred to as a **balloon payment**.

Refinancing - Owners will refinance their original loans when there is a short-term (balloon payment) loan on the property, the equity has increased, the owner needs cash, or when the interest rates drop beyond a point where the benefits of lower interest rates and lower payments offset the costs of paying off the first loan.

The term amortization refers principally to the manner of repaying a debt or obligation. It does not refer to the manner in which the interest due on the debt or obligation is to be paid. A loan amortization table refers to the amount of principle and interest it takes to pay off a loan over a given period of time.

Some real estate loans are **straight loans**. This means that the entire debt or obligation is to be paid at one fixed time. In this kind of a loan there would be no installment payments of principal at all and no periodic payments of interest unless this is provided for in the terms of the note. Ordinarily, the entire obligation, principal and interest, is cleared in a single payment.

Usury Law

In most states, usury statutes limit the amount of interest that lenders can charge on a loan or forbearance of money when the loan is secured by real property.

In California, certain lending agencies have been exempted from such laws. Among those exempted are: banks, state and national banks, industrial loan companies, pawnbrokers, credit unions and some others. A state constitutional amendment extends this group to include:

- ▣ Licensed real estate brokers.
- ▣ Any class of persons exempted by statute (consumer finance lenders, any incorporated admitted insurer).
- ▣ Any successor in interest to any loan made originally by anyone of the exempted lenders.

In California, in circumstances in which the lender is bound by the usury laws, the rate of interest charged on loans for personal family or household purposes (consumer loans) is not to exceed a maximum rate of 10% per annum. The state constitution also states that loans used for the purchase, construction or improvement of real property are not to be considered loans for personal, family or household purposes.

The interest rate charged on the loan or forbearance of money for purposes other than those mentioned above shall not exceed the higher of 10% per annum or 5% per annum plus the Federal Reserve discount rate prevailing on the 25th day of the month preceding the date of the agreement to make the loan.

This discount rate is established by the Federal Reserve Bank of San Francisco on advances made to member banks of the Federal Reserve System.

Conventional Loans

This form of financing is known as **conventional financing**. This means that the lender assumes the risk without any governmental guarantees against loss to support the credit of the borrower. Broadly speaking, it is any real property loan which is not insured or guaranteed by a governmental agency. With the influence of government purchases, guarantees and insurance, loans of this type are usually made by financial institutions known as **institutional lenders**. These include life insurance companies, banks, and savings banks whose loan practices are controlled by law and by adopted policy. These loans are referred to as **purchase money** since they are usually arranged for an original purchase.

Conventional loans may also be secured from private individuals and from such lenders as pension funds, endowed universities and colleges, mortgage investment companies, trust departments of banks, executors of estates, and others who have funds entrusted to them for investment. Such lenders follow no uniform lending practices and, in general, are not subject to national or state licensing laws or the requirements of other regulatory bodies and, as a result, can take greater risks in their investments than the financial institutions. They are referred to as **non institutional lenders**, and are the greatest source of secondary or junior financing.

Under normal conditions, conventional loans are made with a lower loan amount, in relation to the appraisal of the property, than those which are government insured or guaranteed. This relationship between the amount of the loan and the appraisal of the property is known as a loan-to-value ratio.

Conditional commitment: A commitment of a definite loan amount for some future unknown purchaser of satisfactory credit standing.

Firm commitment: A commitment for a definite loan amount for a known borrower (purchaser) of satisfactory credit standing.

Package trust deed: One that covers the real property, appliances, carpeting, drapes, air conditioning equipment, etc., as security for the note.

Debt Income Ratio

Debt income ratio is a loan qualification tool that indicates the fraction that your loan payment on the property is in relation to the net income from the property. This is used by lenders when qualifying a person for an income property loan and measuring their margin of safety. If your annual debt payment of principal and interest is \$10,000 and the net income from the property is \$15,000, then the income is 1.5 times the debt payment. This is expressed as:

Annual debt service = \$10,000

Net operating income = \$15,000 = 1.5

Mortgage Discounts Points

Used by itself, the word **point** means one percent (1%) of the loan amount. On a \$50,000 loan, one point equals \$500 and on a \$200,000 loan, two points equals \$4000.

Lenders charge points for many reasons. Origination fees cover risks to a lender in making a loan to a less stable borrower and compensation for foregoing the higher yields obtainable from other types of investments. Investors, on the other hand, are sometimes willing to pay premium points for attractive mortgage loans. Discount points charged on a loan may be paid by the seller to the lender from the sale proceeds. This is income to the lender and is considered to be prepaid interest for the lender. Points increase the overall yield to the lender because points (prepaid interest) received lowers the total amount of money actually lent.

When lenders charge points, they are said to be “discounting” the loan since these fees are usually deducted from the loan proceeds and the borrower receives less than he/she must repay. When points are involved, an investor must pay money over and above the face value of the note evidencing the loan.

In effect, the word “discount” means a reduction in value or the difference between face value and cash value. The term **discount points** is ordinarily used when the seller is being charged a specific number of points to compensate the lender for contracting to make the buyer a lower than market interest rate mortgage loan, or when the investor is bidding for a seasoned loan as an investment and offers less than the unpaid principal balance based upon the risk involved or yield acquired. Discounting any kind of a loan increases its effective yield to the holder of the note.

A **seasoned loan** is one that has been in existence for a period sufficient for a loan payment history to show a normal method of payment for that loan. A loan with late payments or months at a time with no payment would draw a heavier discount than a loan with all payments on time because of the potential risk.

Points are calculated on the amount of the loan and not on the sale price of a property. Higher discount points (more points) are charged in periods when mortgage money is in short supply and the level of uncertainty in the economy is increasing so that the only way to attract lenders is to discount the mortgages and raise the effective yield to the final investors. Thus, money market conditions greatly influence the extent to which points are charged. It is also important to recognize that discount points will vary according to the investors and lenders estimate of the quality of the property and of the character of the buyer (borrower).

Most institutional lenders also require that the borrower make payments for 1/12th of the annual insurance premiums and 1/12th of the annual taxes along with their monthly payments. These payments are placed into an impound account. This practice guarantees the lender that the borrower makes these payments and is not hit with a major layout of monies once each year. Fire insurance is demanded by most lenders as a safeguard for the money they have invested in the property.

It is an expression that one should have sufficient fire insurance so that the insured would neither gain nor lose money if the insurance proceeds are given in case of a total loss. If a home has an insured value of \$100,000, and carries a \$200,000 insurance policy, the company will accept your premium on the \$200,000 but in the event of a total loss you would receive \$100,000 to replace the current value of the improvements. If you under insure the property, planning to take advantage of small losses only, then the insurer will require you to be a co-insurer. If the insured value is \$100,000 and you insure for only 50% of value and then have a loss of \$20,000, you would be a co insurer for 50% of the \$20,000 loss and receive only \$10,000 in insurance proceeds.

Conventional loans are typically offered in two different packages, fixed rate loans and variable rate loans. The reason behind these two packages being offered on the market is because lending institutions were caught in the early 1980's with all fixed rate loans at around 8%. When the interest rates climbed into the 15% to 20% range, lenders lost billions of dollars because of their portfolio of fixed rate loans at low interest rates. The variable rate loan offers a much lower interest rate to start. This allows more people to buy because payments are based on a lower rate making the monthly payment lower. The rate then changes either up or down according to market conditions and is set by a precise index. The federal government created a law that makes the loan subject to a maximum rate no higher than 5% of the original rate set on the loan.

Institutional Lending Agencies

Insurance Companies

In general, life insurance companies make conventional loans on all types of properties. Operations are governed by the laws of the state in which the company was formed. In California, under the Insurance Code, life insurance companies are permitted to make conventional loans of up to 90% of the market value on a single-family residence, or 80% of the market value on other types of real property.

Life insurance companies prefer to make long-term loans on large, high quality properties such as large shopping centers. For the most part, mortgage companies solicit borrowers for insurance company loans.

The lending characteristics of an insurance company are:

- ▢ Many long-term loans.
- ▢ Many residential loans but a number of commercial and industrial loans.
- ▢ Make medium sized loans relative to value.
- ▢ Prefer large loans.
- ▢ Buy loan packages.
- ▢ No geographic limitations but selective as to neighborhoods.
- ▢ Usually low interest rate.
- ▢ Almost no construction loans.
- ▢ Borrower's ability to repay a major concern.
- ▢ Usually seek to avoid administration of a loan.

State law limits the term of a residential loan to the remaining useful life of the structure or 40 years, whichever is less. Such loans must be fully amortized within this time limit. The rate of interest is affected by the age of the property, the credit qualifications of the borrower, the amount, and term of the loan.

Insurance companies make more loans on business and large commercial properties than any other institutional lender. They normally work with mortgage companies who find the borrowers that fit their profile.

Pension Funds

In the past few decades, private pension funds have accumulated billions of dollars. In recent years, a trend has developed where these funds invest not only in large scale real estate financing investments, but also in portfolios of FHA and VA backed mortgages.

Savings Banks

For many years, these lenders accounted for the greatest share of home loans. They include both federally chartered and state chartered banks. They are regulated by the Federal Home Loan Bank which lends money on the open market. These lenders are corporations that have their stocks traded by the major exchanges. Since they are accountable to their stockholders their goal is to increase profits.

Federal savings banks are members of the Federal Home Loan Bank System and are subject to its supervision. In California, there are many state chartered institutions which operate under the provisions of the Financial Code of California. The principal function of savings banks is to gather the savings of as many people as possible and lend these savings to other people, principally for building, buying, improving or refinancing residential real property.

In November 1980, the Federal Home Loan Bank Board generally eliminated all dollar restrictions on loans that can be granted by savings banks under their jurisdiction.

Although the Federal Home Loan Bank Board requires that the loan-to-value ratio shall not exceed 90% of the value of the security property, it does allow a loan-to-value ratio not to exceed 95% of the value of the security property in special cases. The 95% loan-to-value ratio can be extended in those instances in which the security property is to be occupied by the borrower and monthly payments for taxes and assessments are paid in advance to the lender by the borrower. If the unpaid balance of the loan exceeds 90% of the value of the property the borrower must maintain private mortgage insurance with an approved insurer for the portion of the unpaid balance of the loan that exceeds 80% of the value of the security property for the benefit of the lender in case of default by the borrower.

Commercial Banks

Commercial banks prefer loans secured by property near its office; prefer to have had a prior relationship with the borrower, and prefer to make short-term loans. Federal banks are regulated by federal statutes. State banks are governed by state laws which limit their activities.

On fully amortized conventional loans secured by a first lien on residential or income or agricultural property, both state and national banks are restricted to maximum loans of 90% of the appraised value of the property and a maximum 30-year period. Often bank loans are made at the repayment rate of 1% of the loan per month, including interest. On a fully amortized loan, the rate of interest affects the loan period. For example: A 5% loan at 1% per month would take approximately 11 years to pay off, while a 6% loan would run a little under 12 years. The longer the term of the loan the greater will be the cost in total interest paid.

Mutual Savings Banks

Mutual savings banks are located mainly in the northeastern states. They serve the same purpose of the savings banks in the states in which they function.

They are important sources of funds to California mortgage companies because state laws governing their investments permit them to make FHA insured and VA guaranteed loans in the United States.

Mortgage Companies

Mortgage companies are usually privately-owned firms which have limited funds for outright mortgage lending. Ordinarily, mortgage companies can be either mortgage brokers or mortgage bankers, or they can be both. Mortgage brokers arrange loans as loan correspondents for life insurance companies, mutual savings banks, pension funds, etc. Mortgage bankers originate, finance and close first mortgage loans and sell such loans to institutional investors. After the loans are sold, typically, they are serviced by the mortgage broker under a contractual relationship with the beneficiary. Also, they are actively engaged making short-term construction loans. Many mortgage companies actively solicit by classified ads, direct mail and internet advertising for short-term equity loans on existing properties. On most loans made through mortgage companies, they will continue to collect the payments and make additional income from the service charges collectable for this service.

Mortgage companies are established under individual state laws and in California they must have a real estate broker license to operate. It is the policy of mortgage companies to be active in the one-to-four unit loan market, either conventional, FHA insured, and VA guaranteed loans that are readily marketable in the secondary mortgage market. They sometimes act as middlemen by seeking permanent loan commitments for developers and investors and then arrange for construction financing with other lenders.

It is the duty of the mortgage company, before arriving at a commitment to make the loan, to consider the value of the property, the amount of the loan in relation to that property, and the ability and history of a borrower to repay the loan.

Construction Financing

Construction financing is given following the lenders market analysis of the contractor's ability to build and sell the property. Some of the expenses of construction are:

- ▣ Indirect expenses
- ▣ Labor costs
- ▣ Building permit
- ▣ Material costs
- ▣ Sub contracts
- ▣ Indirect costs of construction
- ▣ Preliminary expenses (consultation fee, surveys)
- ▣ Professional fees (architects, engineers, legal)
- ▣ Taxes during construction
- ▣ Financing charges
- ▣ Administrative and overhead costs

A **construction loan** is made to complete the improvements on real property. An interim loan is another name for a construction loan. A progressive payment loan is the name of a type of construction loan. A commercial bank or mortgage company situated in the area of the construction can supervise the project at a lower cost. Therefore, this type of lender tends to make short-term loan transactions such as construction loans. The money is rarely if ever paid in advance. As each phase of construction is completed, the contractor receives a percentage of the loan or the amount of money used during that phase. These are referred to as obligatory advances. The maturity date of the loan is measured from the date of the note. With FHA construction loans on the other hand, maturity is computed from the date of the first payment made by the borrower.

It is the practice of these short-term construction loan lenders to “hold back” 10% of the money due the contractor until the lien period for mechanics has expired. At this time, the contractor would receive his/her final payment. Construction financing is usually paid off after the building has been completed by refinancing the property on a long-term loan. The lender on the construction financing is taken out of the picture with the new loan.

Standby commitment is a type of loan commitment, also called gap financing, employed in the event a contingency in a take-out loan commitment is not met. The standby would be used until the contingency is satisfied.

The borrower who does not have a take-out loan commitment is looking for a more favorable permanent loan from still another lender. If more favorable circumstances do not develop, the permanent loan will be closed by the lender who made the standby commitment.

The lenders who prefer to make long-term loans are savings banks and insurance companies. If the lender likes the proposed property, he/she would prefer to agree to make the long-term loan rather than the construction loan. To accomplish this, the lender would issue a take-out loan commitment often called a take-out letter. This letter assures both the contractor and the construction loan provider that the money is ready when the construction is complete and the last payment on the interim financing has been provided to the contractor.

Participation loan: Inflationary tendencies have brought increased use of a number of debt equity combinations in real estate finance. These “piece of the action” types of plans can be arranged in many ways. They are usually referred to as a participation loan by the lender. For example: The interest rate stated was 9% per annum and the builder asked the lender to reconsider the terms of the loan and give him/her a lower annual interest charge. The insurance company suggested that they would lower the interest rate 1/2% per year if the builder would grant it a 2% equity position in the ownership.

Characteristics of Lenders

Insurance Companies

1. Long-term loans
2. Lowest loan-to-value ratio
3. No construction loans
4. New properties
5. Usually do not service loans

Savings Banks

1. Long-term loans
2. Federal & state chartered
3. Dominant lenders in residential financing

Commercial Banks

1. Short-term loans
2. Construction loans
3. People dealt with before

Mutual Savings Banks

1. Long-term loans
2. They serve the function of the savings banks in the states in which they function.
3. Located in northeast part of the country

Mortgage Companies

1. They solicit loans
2. They service loans
3. They do not lend their own money (mortgage bankers do lend their own money)
4. They act as loan correspondents

Agency Insuring Savings Deposits

- FDIC (savings and commercial banks) federal deposits insurance corporation

Farm Loans

Agencies making farm loans - According to percentage of farm loans made, lenders would be identified as follows:

- Individuals and others 37%
- Federal Land Bank and other federal agencies 36%
- Life insurance companies 13.9%
- Commercial banks 13.1%.

Since its creation in 1917, the federal land banks (12 in all), have made their loans through more than 1000 national farm loan associations throughout the country. These associations are wholly owned by their farmer members. They exist for the purpose of supplying needed amounts of mortgage financing and are not institutions for the deposit of money. The Farmers Home Administration is a government agency which makes loans and/or guarantees loans for specific agricultural purposes.

Federal Housing Administration (FHA)

The National Housing Act of 1934, created the Federal Housing Administration (FHA) with the authority to: (Title 1) insure loans made to homeowners for the repair, alteration and improvement of their property; and (Section 203(b) of Title 11) insure lending institutions against loss from mortgage/trust deed loans made on one-to-four family houses and large rental projects. The main purpose of the FHA program and, incidentally, also the VA program, has been to meet the housing needs of all citizens through a flow of money and credit. These federal housing programs have had a sizeable influence in expanding the housing market. Thus, real estate licensees, builders and lenders must be familiar with the laws under which the program was established if they are to benefit from it. The largest and most important activity of FHA is the insurance, under Section 203(b) of Title II, of mortgages on new and existing one-to-four family homes.

Advantages of FHA Financing

Among the advantages of FHA financing are:

- ▣ Monthly, budgeted payments suited to the borrower's financial ability to pay;
- ▣ Elimination of short-term financing that removes the need for expensive refinancing;
- ▣ A high loan-to-value ratio;
- ▣ Protection for the lender;
- ▣ Monthly payments include fire insurance and local taxes;
- ▣ Prepayment of loan without penalty
- ▣ Improvement in housing standards due to FHA minimum property requirements (M.P.R.). For example, all staircases must have at least one handrail.
- ▣ Limited transferability to others without penalty.
- ▣ Lower interest rates than conventional financing because of the protections and insurance.
- ▣ Interest rates will be lower for owner-occupied properties than non owner occupied properties.
- ▣ A maximum loan service fee of 1%. This fee is a non tax deductible fee for I.R.S. purposes

FHA does not make loans. It insures loans made by lending institutions such as banks, savings and loan associations, life insurance companies, independent mortgage companies and state agencies. FHA considers a supervised lender to be any lending institution subject to periodic examination by a government agency, whether state or federal. Thus, independent mortgage companies and some life insurance companies are called non-supervised lenders. An individual person may not become an FHA approved mortgagee. Pension fund investors usually are active as investing mortgagees.

All approved lenders are required to service the insured loans in accordance with the practices of prudent lending institutions. If the borrower defaults, the lender may foreclose and tender the property to the FHA in exchange for debentures or cash, or with prior approval of the FHA the lender may assign the defaulted mortgage prior to foreclosure action. If the property is readily saleable at a price which will exceed the amount of the loan including all charges, the lender would undoubtedly sell the property and not apply for the cash or debentures. Most claims are paid in cash.

Debentures are guaranteed both as to principal and interest by the U.S. Government and are therefore readily marketable. The operation of the Mutual Mortgage Insurance Plan provides for losses to be paid from the reserve which is built up in the general surplus account to which all aggregate net income is credited.

A borrower does not apply directly to HUD or FHA for a mortgage loan. Instead, application is made for a mortgage insurance commitment to a HUD/FHA approved mortgagee. The mortgagee takes the application and submits it for mortgage insurance to HUD/FHA on prescribed forms.

Under the HUD Direct Endorsement Plan, approved mortgagees who have made an application to HUD may process the application through the loan closing without prior HUD review, except for construction projects.

Prompt processing of applications requires that they be submitted on prescribed FHA forms. Additional exhibits which are required by FHA officials and must accompany applications for a loan, include an original or certified copy of purchase contract (purchase agreement), credit report on the mortgagor, verification of deposit, verification of employment or financial statement and, in case of new construction, the drawings and specifications.

In all cases the mortgagee first applies for a conditional commitment (even though the prospective mortgagor is known). The firm or conversion commitment is requested when the mortgagee desires a contract with the FHA Commissioner to insure the outstanding conditional commitment with a specified mortgagor who is acceptable to the FHA. If the borrower on the property appears to the real estate agent to lack minimum FHA standards, it would probably be better to look for a lender who deals in conventional rather than FHA loans.



The limitations and designation of maximum loans, loan-to-value ratios, and amortization periods are subject to change by the Congress through new legislation.

With FHA insured loans, the mortgage loan may bear interest at any rate agreed upon between the lender and the borrower. HUD does not set interest rates for FHA backed loans. Interest must be paid in monthly installments on the principal amount then outstanding.

Mortgage Insurance Premium

FHA requires both up front and annual mortgage insurance premiums. The up front premium is to be paid at the close of the escrow. The up front premium can be paid by anyone. If the buyer desires to finance the premium in the loan that is being made, then the premium will be added to the loan. When adding the premium to the base loan that loan will be called the Gross Loan. The monthly payments and the interest and discount points will all be based on the gross loan. The annual mortgage insurance premium will be paid monthly with the regular payment. The authorized maximum loan amount can be exceeded if the excess is for the mortgage insurance premium. This premium may not be considered as an acquisition cost for computing the down payment. This money goes directly to FHA. Annually, if there are surplus monies remaining after expenses have been paid, the surplus monies might be distributed to the qualified FHA borrowers who paid off their loans during that year and applied for the unused portion of their insurance.

The down payment must be from the buyer's personal assets or a gift from an approved source. An approved source may be:

- the borrower's relative
- the borrower's employer or labor union
- a close friend with a clearly defined and documented interest in the borrower
- a charitable organization
- a governmental agency or public entity that has a program providing home ownership assistance to low- and moderate-income families, or first-time homebuyers.

With FHA insured financing, the lender may charge a seller discount points. The FHA borrower may also be required to pay discount points to the lender in addition to an FHA application fee (origination fee), which is an initial service charge (usually one percent of the mortgage amount). This matter is negotiated between the borrower and the lender. This loan origination fee is in no way connected to the charge for discount points.

The application fee (origination fee) is associated with expenses of obtaining the loan. It is not a deductible item for income tax purposes since it is considered to be a cost for services rendered, not interest on borrowed money. The borrower may also be required to pay fees for a credit report, and FHA appraisal, drawing documents and escrow fees, title insurance (CLTA or ALTA), impounds (taxes and insurance), termite inspection, reconveyance, notary and recording fees. The payment of some of these fees is negotiable with the seller.

Every financial institution that makes loans upon the security of real property containing a one-to-four unit residence and located in this state, or which purchases obligations secured by such property (secondary money market) and receives money in advance for payment of

taxes and assessments on the property for insurance, or for other purposes relating to the property, shall pay interest on the amount so held to the borrower. Interest shall be at the rate of at least two percent simple interest per annum. Such interest shall be credited to the borrower's account annually or upon termination of the contract, whichever is earlier.

Mortgage discounts: The FHA lender can negotiate "discount points" as well as interest rate with the borrower. A party to the sale transaction other than the borrower seller or broker may pay the discount.

HUD provides insurance for low income housing and works with local governments to assure that this form of housing is built in neighborhoods that will insure that the development will maintain its value and the tenants are placed into affluent school districts. Often, HUD provides the insurance for the money for local governments to rehabilitate existing low income housing. A turnkey property is a specific term used by HUD in providing low income housing. It describes a property that has been completely rehabilitated and is ready for the subsidized tenant to move in.

Department of Veterans Affairs (VA & GI Loans)

In 1944, Congress enacted the Servicemen Readjustment Act, which became commonly known as the "G.I. Bill of Rights." It provided for a broad program of benefits for veterans of WW II. Then followed a series of successive amendments affecting the loan guarantee benefits for WW II veterans and, in due course, veterans of later conflicts were included. Enactment of the Veterans Housing Acts of 1970 and 1974 made some very important changes in the VA home loan program which greatly expanded the viability of the program to veterans. The time limitations on the use of loan guarantee entitlements were removed. They restored those which had elapsed or expired whether the entitlement was derived from WW II, the Korean Conflict or Post Korean Conflict Service. The requirements for restoration of eligibility were eased.

The method is like FHA loans in such items as monthly budgeted payments, low interest rates, high loan-to-value ratio and prescribed appraisal techniques, but unlike FHA, the Veterans Administration guarantees rather than insures loans.

As of October 28, 1992, the Veterans Home Loan Program became law. This program allows that discount points and interest rates are completely negotiable. If the points or the interest rate change before a loan closes, the loan must be re underwritten before the loan is allowed to close. An interest rate and disclosure statement must be furnished to the veteran at the time of the loan application. This form clearly explains lock-in agreements, discount points, and interest rates.



V.A. Loans:

<http://lumbleau.com/va-home-loans>



Advantages of VA Loans.

Some of the advantages which VA loans still have include:

- ▢ No mortgage insurance premium is charged
- ▢ A maximum loan service fee of 1%. This fee is a non tax deductible fee for I.R.S. purposes.
- ▢ No down payment if the price does not exceed CRV up to the amount of the maximum permissible loan. In other words, one hundred percent financing.
- ▢ No maximum limitation on purchase price If loan is at the VA appraised value or less, the buyer may pay the additional amount.
- ▢ Amortization Plan, i.e., loans may be amortized under any generally recognized plan, such as equal, increasing or decreasing payments.
- ▢ Prepayment of loan without penalty.
- ▢ Appraisal methods used are the same as FHA. The VA appraiser issues a CRV.

Purpose of loan: In addition to home loans where the veteran must intend to occupy the home. VA loans can be made for purchase of a farm residence to be occupied by the veteran as a home, the purchase of a mobilehome with or without the lot, and to refinance existing mortgage liens or other liens of record on a dwelling occupied by the veteran. Loans are only for owner-occupied dwellings.

In more recent years the VA has adopted regulations that give them control over such features as streets, utilities, lot size, construction standards, and setbacks of subdivisions that utilize VA financing.

If there is a default on a guaranteed VA loan, the veteran's eligibility is charged with the amount of the deficiency that has to be paid because of the guarantee.

Certificate of Reasonable Value (CRV)

The appraisal of the property made by VA is known as a **certificate of reasonable value (CRV)** and sets the maximum loan amount to the veteran. If the veteran desires to pay a price above the CRV, he/she may do so but must pay cash for the excess. If the cash payment is borrowed, it must be shown in the financial statement used to qualify for the loan. Anyone attempting to circumvent this regulation is subject to federal penalty.

The VA guarantees most loans and insures the rest for qualified lending institutions that maintain a lender's insurance account. The VA guarantee to the lender is 40% of the loan, but not to exceed \$36,000. If there is a default on a guaranteed loan, the VA pays the lender a specified maximum amount, which is reduced proportionately as the loan is paid. On insured loans, the VA will pay the net loss of the lender up to the amount of the insurance account. If there is a default on a guaranteed VA loan, the veteran's eligibility is charged with the amount of the deficiency that must be paid because of the guarantee.

The VA and the FHA are not concerned with the price a person pays for a property. An appraisal is made and the loan, insurance and/or guarantee is based upon that appraisal. The purchaser may pay over the appraised amount without affecting his/her ability obtain the financing.

The veteran purchase contracts must include a clause that affords the veteran the opportunity of reaffirming the contract or withdrawing from the transaction when he/she receives notice that the sale price exceeds the CRV. If the contract does not include such a clause, the application for approval will be rejected and the closing could be put off for up to two weeks' time. The VA suggests that the clause be worded as follows:

VA Escape Clause

"It is expressly that, notwithstanding any other provisions of this contract, the purchaser shall not incur any penalty by forfeiture of earnest money or otherwise be obligated to complete the purchase of the property described herein, if the contract purchase price or costs exceeds the reasonable value of the property established by the Veterans Administration. The purchaser shall however, have the privilege and option of proceeding with the consummation of this contract without regard to the amount of the reasonable value established by the Veterans Administration."

California Farm and Home Purchase Act (CalVet)

This plan offers certain advantages not available under FHA or VA. However, the Department of Veterans Affairs may accept an appraisal by either FHA or VA to fill the appraisal requirement to purchase under the CalVet program.

CalVet provisions require owner occupancy. However, the whole nature of the transaction is different in that it involves a **contract of sale** with the title remaining in the State. Because of this, no discount points are involved. A California veteran must apply to the California Department of Veterans affairs for a CalVet loan within 30 years following release from active military duty to qualify for such a loan. However, those who are wounded or disabled from war service or were prisoners of war have an indefinite period in which to apply.

The Department will now require that all CalVet loan applicants also qualify under applicable federal laws and regulations governing the permitted uses of tax exempt bond funds.

Interest rates are less than either FHA or VA. The CalVet rate under both the 1943 Act and the 1974 Act is a floating rate. The rate changes from time to time but this does not affect the



amount of monthly payment, merely the length of time necessary to pay the contract. The borrower must take out disability and life insurance under a plan which guarantees clear title to the property for survivors of the veteran purchaser without further payment if he/she or she dies. The Department of Veterans Affairs holds the title of the property. The borrower may not transfer, assign, encumber or rent the property without the written consent of the State. Funds for the operation of the CalVet plan are derived from the sale of bonds voted upon by the public. The State Department of Veterans Affairs handles the financing transaction

Federal Government & Real Estate Economic Activity

Economic forces are difficult to measure directly, even though they exert their influence anywhere people live. Because of this, we resort to certain measures of economic activity (indexes). The most common and most important measures at the national level are:

- Gross national products (GNP), which is, in terms of dollar value, the sum of all goods and services produced, consumed, saved and invested by all elements in a nation
- Employment and unemployment
- Consumer price index (CPI)

Statistics for these measures may be compared from one time to another and, except for GNP, for one community or area to another at both regional and local levels. When the consumer price index increases, the value of the dollar decreases.

Some economists use the phrase “cost of living” referring to an index. A rise in the index would indicate that the value of the dollar is weakened, thus more dollars would be necessary in an inflationary period to buy the same number of commodities than could be acquired for a lesser monetary sum in a period that had a lower cost of living index.

As economic activity increases, unemployment decreases. This again influences prices because of the increase in the income of potential buyers. This would influence a non homeowner to leave those ranks and become a homeowner.

Lenders loan money to realize income. The rate of interest indicates the rate of return they expect to receive on their investment. Purchasers of income property also are interested in earning money on their investments and we base their rate of return on capitalization rates (cap rate). Investors usually demand a higher rate of return than do commercial lenders. When commercial lenders increase the rate of return (interest rate), investors also increase their rates.

In times of inflation, the value of real property will tend to increase as rents increase. If a tenant is on a fixed long-term rental not tied to an economic index, the value of the total property and the corresponding equity of the owner will decrease. Conversely, in a time of deflation, as seen in the greater part of California during the Great Recession, the value of the dollar increases allowing the purchase of a greater valued property for less money.

Many loans are influenced by economic activity as shown by these indicators. Variable interest rate loans will have their rates increase or decrease based on these indexes and on the influence of the Federal Reserve system. These loans are provided by every major type of lender in the marketplace. Remember, real estate loans are “long-term investments.” In a market where people demand liquidity (cash or its equivalent,) real estate funds tend to dry up. When liquidity is desired, funds are invested in short-term commercial notes or government securities.

Most investors, during an inflationary period fear erosion of capital from escalating interest rates and turn to short-term investments which usually provide a higher yield.

The prime rate, which increases or decreases immediately following an action by the Federal Reserve system, influences the money rates that affect all borrowers. If interest rates go down, the monthly payment on a real estate loan goes down in proportion, and the number of potential buyers entering the market increases. Conversely, as interest rates increase the number of buyers capable of qualifying for a loan at the higher monthly payments decreases.

In times of relative economic stability, large numbers of people place their savings in financial institutions (e.g., banks, savings banks, and credit unions) which invest these funds for their mutual profit. Periodically, economic conditions change to such a degree that it becomes more profitable for investors to withdraw their savings from the deposit type institutions and invest directly into securities, including stocks, bonds and other financial assets. In the periods during which we see shifts in the flow of investment funds out of financial institutions into the market for other financial assets, we experience what is called **financial disintermediation**. In the years when it is more advantageous for investors to give their dollars to financial institutions for investment, we are said to be experiencing what is called financial intermediation.

Numerous studies of economic activity have been maintained by many professional companies over the years. These studies reveal a rhythmic change from booms to depressions interspersed by minor periods of prosperity and minor business recessions. The regularity of periodic business swings from boom to bust has led to the belief in a business cycle which is described as “depression - recovery - prosperity- recession,” subject to minor disturbances that will inevitably repeat its swings.

Government intervention, other than the actions of the Federal Reserve System, rarely have any lasting effect on the business cycle, e.g., the government placing low income housing in major metropolitan areas.

There is also a housing market cycle to take into consideration. The housing market cycle is a major factor in the economics of the nation. Builders build without conferring with one another about how much construction their company does as a part of the total amount of construction needed to be purchased to satisfy the buying demand of the time. Usually they, within six years, forget the last overbuilding cycle and again overbuild the buying demand. It takes from 12 to 18 months to reduce the overbuilt inventory until the supply again meets the demand. Builders then slowly start to build and increase the number of houses built and sold until another six to eight years pass, and they again overbuild.

When prices decline, people can purchase more property than they could previously. This would happen because of the increase in the value of the dollar.

California economic activity is on the rebound and a buyer's market has turned into a seller's market after the Great Recession. We are currently experiencing a seller's market that has outperformed any previous recovery.

These terms are used every day in our profession:

Buyer's market: A time in the economy when real estate prices are decreasing. Buyers are in a favorable position to negotiate a lower price on a property. Usually, during this time there are excess listings available and, during the lowest period, there are foreclosed properties available at a lower price.

Seller's market: A time in the economy when real estate prices are increasing. Sellers are in a favorable position to negotiate a higher price on a property.

There are different ways in which the Federal Government can influence economic conditions in this country. One of the principal means by which this influence is exercised is through the operations of the Federal Reserve Bank.

Federal Deregulation

Deregulation indicates the reduction of control in financial institutions. In the 1980's, when the federal government deregulated the saving and loans industry, they were permitted to make loans on assets other than real estate, such as junk bonds, restaurant chains, and racehorses.

The Federal Reserve Bank

The **Federal Reserve Bank System** ("the Fed") is the nation's central bank. The chief responsibility of its governors (the Federal Reserve Board) is to regulate the flow of money and credit to promote economic growth with stability. They do this by exercising a monetary policy geared to encourage high employment, stable price levels, a healthy economy and a satisfactory international balance of payments. Monetary policy may be used to counteract inflation, recession or any other undesirable or harmful shift in the country's economy.

The Fed was created by Congress in 1913 by the **Federal Reserve Act**. The Board of Governors formulates monetary policy and shares with 12 Federal Reserve Banks the responsibility of applying that monetary policy and setting money supply goals. The country is divided into 12 districts with a Federal Reserve Bank in each district. In a very real sense the Fed is a bank's or banker's bank. The governors of this bank are appointed by the President of the United States and are confirmed by the Senate for 14-year terms. The chairman and vice-chairman are appointed and confirmed for four-year terms.

Monitoring the Money Supply

The economy of the nation does not retain its prosperity and growth potential unassisted. Unpredictable variations in the volume of bank withdrawals and deposits, cost of money and credit, unemployment, inflationary influences and world economic conditions all affect our economic well-being. To avoid the peaks and valleys and "boom or bust" business cycles that spawn liquidity and credit crises, the Fed monitors changing economic and financial

conditions and applies appropriate controls or pressures. The Fed influences the supply of money and credit available and thus controls the behavior of lenders and borrowers and even non borrowing spenders (cash customers). These controls are far reaching, often affecting interest rates, jobs and the fortunes of many on a world wide basis.

To accomplish its goals, the Fed uses three basic tools or actions:

1. **Reserve Requirements.** By establishing reserve requirements, the Fed increases or decreases the amount of money in circulation. Member banks must set aside and keep a certain percentage of each deposit received as reserves. An increase by the Fed in reserve requirements means banks have less money to lend, interest rates increase, and borrowing and spending slows. A decrease in reserves increases money the banks must lend, interest rates may decrease, and borrowing and spending increases. This would bring more buyers into the market, driving up the price of homes. During a “tight money policy” period, the Federal Reserve Board demands a higher reserve, shrinking the money supply and driving up interest rates. This lowers the total loans given by lenders.

During the early eighties, to drastically reduce a heavy inflation, the Federal Reserve Board took the “tight money” policy attitude to the point that the availability of long-term loans dried up almost completely, or were at extremely high interest rates with heavy discount points. Lending institutions were unable to make loans. The real estate community responded with “creative financing,” including “wrap-around” loans and second and third trust deeds taken back by owners.

The minimum interest rates a commercial bank is willing to lend their most credit worthy clients is called the **prime rate**. This rate is influenced, almost entirely, by the action of the Fed.

2. **Discount rate.** The discount rate is the interest rate a bank must pay to the Fed when the bank borrows money. A decrease in the discount rate will encourage bank borrowing. Bank borrowing increases deposits at the bank and allows it to lend more. A boost in the discount rate does the opposite. Discount rates obviously affect the interest rate that the average home buyer will pay for new financing.
3. **Open Market Operations.** The Fed also uses the tactic of open market operations (buys and sells government securities) to influence the amount of available credit. When the Fed buys government securities from the public, it stimulates the economy because the cash it pays the sellers is deposited into sellers’ bank accounts which increases the banks’ reserves. With additional funds on deposit, the banks may extend more credit to borrowers.

However, if the Fed is selling securities, the opposite occurs: buyers withdraw funds for payment from their banks, reserves in the buyers’ banks decrease, and less credit and lending is available through the banking system

Open market operations are the most flexible and frequently used instrumentality employed by the Fed for expanding or slowing the economy. The Fed engages almost every day in securities trading to influence the availability of money and credit. These activities are conducted by the Federal Reserve Bank of New York.

If the frequency of the business cycle increases with an accompanying rapid change in business and money conditions, flexibility to meet changing conditions is wise. Long-term investments restrict such flexibility so money flows to highly liquid sources.

Federal Home Loan Bank

The Federal Government took another step in its effort to stabilize economic conditions by establishing the Federal Home Loan Bank in July 1932. The Home Loan Bank Board is the federal government's regulatory agency for all federal savings banks across the country. It operates for the savings bank industry in much the same way the Fed operates for the commercial banks. This Home Loan Bank System is made up of 12 District Federal Home Loan Banks operating in 12 separate districts throughout the country.

Federal Deposit Insurance

In 1934, Congress took another step to help restore people's confidence in the various banking systems in operation in the country. They established two distinct permanent government operations to safeguard the deposits of the general public in both banking institutions and savings banks.

The Federal Deposit Insurance Corporation (FDIC) was established to insure savings deposits in the country's commercial banks. The Federal Savings and Loan Insurance Corporation (FSLIC) was created at the same time to insure savings deposits in savings banks throughout the country. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished FSLIC and transferred the responsibility for savings and loan deposit insurance to the FDIC. Under FDIC, savings accounts are insured to a maximum of \$250,000 for each insured depositor as of 2017.

Other Government Influences

A more direct way in which the federal government can influence the economy is by making changes in the federal income tax laws. We have experienced the effects of such changes in the last several years. Very simply, by increasing federal income taxes the supply of money at the disposal of the average citizen will certainly diminish. The opposite would be true if the tax rates were lowered. In that event, there would be greater sums of money at the disposal of the ordinary taxpayer.

Indirectly, too, the federal government can influence the economic health of this country by implementing various government spending programs which operate in different areas of the country. The inpouring of the government's money from such programs certainly adds to the supply of money in those areas of activity.

Mortgage Operations of Federal Government Agencies

The federal government's influence on real estate financing was expanded considerably with its participation in secondary mortgage market activity. Earlier in this chapter we established that loans are made by lenders in the primary mortgage market. We also learned that these loans are later sold by the same lenders in what is referred to as the secondary mortgage market. The existence of this secondary market makes it possible for lenders, subsequent to making a loan, to sell the paper (the promissory note and the attendant security instrument in California, a trust deed) to someone else. In this fashion, they avoid the ordinary waiting period for the borrower to repay the loan before they can use the money again to make new loans.

Because lenders have a ready marketplace in which they can dispose of loans that they have just processed, they can almost immediately generate new loans to new borrowers. Realistically, their profit is derived in part from the fees they charge their borrowers in creating loans, in part from the discounts at which they sell the loans in the secondary market and in part from the fees they earn for servicing the loans for the agencies that purchase the paper in the secondary money market.

The primary reason for creating and maintaining a viable secondary market is to make it possible for the lending institutions who make loans on residential property to have greater amounts of money available to make even more loans to consumers and to keep our credit based economy alive and growing.

Secondary Market Operations

There are three government sponsored agencies which dominate the secondary mortgage market currently. These companies play a major role in mortgage loan activity and are often referred to as "quasi governmental corporations." Though they do business in corporate form, they are very much controlled by the federal government. Fannie Mae and Freddie Mac were taken over the government in 2008 due to losses incurred during the Great Recession. These three agencies are:

- ▣ The Federal National Mortgage Association (FNMA) **Fannie Mae**
- ▣ The Government National Mortgage Association (GNMA) **Ginnie Mae**
- ▣ The Federal Home Loan Mortgage Corporation (FHLMC) **Freddie Mac**

Federal National Mortgage Association

Fannie Mae was originally organized in 1938 under Title III of the National Housing Act of 1934 to create a secondary market for Title 11 FHA insured mortgages. However, in retrospect, the agency's real objective was to provide liquidity for government insured mortgage loans insured at high loan-to-value ratios and at relatively low rates of interest. The association, in effect, was to provide funds for the stimulation of new construction by purchasing mortgage obligations insured up to 100% of loan value by another government agency. It was intended that associations of this type would be organized by private individuals and operate under

Federal charter and supervision. Up until 1938, no such associations were organized, and the Federal National Mortgage Association was created.

In 1948, FNMA was re chartered to allow the purchase of VA guaranteed loans. In 1972 under congressional authority, Fannie Mae was permitted to enter the secondary market for the purchase of some conventional home mortgages. Consequently, FNMA is now authorized to purchase FHA, VA and conventional loans. FNMA increases the credit available in the mortgage market for residential financing by attracting new funds through sales of notes it issues. FNMA operations are under the supervision of the secretary of the Department of Housing and Urban Development.

Government National Mortgage Association

Under the Housing Act of 1968, the existing Fannie Mae was partitioned into two separate corporations. The newly created corporation under the 1968 act was called the Government National Mortgage Association commonly called **Ginnie Mae**.

In 1970, a Mortgage Backed Securities Program was initiated to increase liquidity in the secondary mortgage market and to attract new sources of financing for residential loans. Through this program, Ginnie Mae guarantees securities privately issued by financial intermediaries. These securities are backed by pools of mortgages. The investors who purchase the securities receive a “pass through” of the principal and interest payments on the pool of mortgages, less amounts to cover servicing costs and certain GNMA fees. Ginnie Mae guarantees that the registered securities holders will receive timely payments of scheduled monthly principal and interest as well as unscheduled recoveries of principal. If homeowners fail to make their mortgage payments, the securities issuers using their own resources must advance the payments to the registered securities holders.

Ginnie Mae does not purchase mortgages, as do Fannie Mae and Freddie Mac, but simply adds its guarantee to mortgage backed securities issued by approved lenders. Mortgage bankers, savings institutions, commercial banks and other approved types of financial institutions are securities issuers, and because of the federal warranty (pledge of full faith and credit of the U.S. Government), and uniformity of the securities, these GNMA instruments are considered by many to be as safe, as liquid, and as easy to hold as treasury securities. Underlying the securities are mortgages which are used by Ginnie Mae as collateral for the guarantee. The issuer is responsible for acquiring and servicing the mortgages and for marketing the securities it issues.

Ginnie Mae also performs certain special assistance functions on behalf of the federal government. Under these programs GNMA purchases mortgages to accomplish two statutory objectives:

1. Provide support for types of housing for which financing is not readily available, such as housing for low income families and the elderly.
2. To counter declines in mortgage lending and housing construction.

Federal Home Loan Mortgage Corporation

FHLMC, (Freddie Mac) was created in 1970 by the Emergency Home Finance Act. **Freddie Mac** is a government agency with the designated purpose of serving as a secondary market facility for mortgages under the sponsorship of the Federal Home Loan Bank (the agency that supervises Federal Savings Banks.)

FHLMC is permitted to buy and sell FHA, VA, conventional loans and mortgage participations. It does not make direct loans to home buyers. Buyers, however, may seek a mortgage from an institution eligible to sell the loan to the FHLMC.

Institutional lenders (mortgagees) may sell existing mortgages to FHLMC. Freddie Mac may then either resell the mortgages directly or sell securities on the open capital market that are backed by the mortgages they have purchased.

Since these three agencies so dominate the secondary mortgage market their policies pretty much dictate the policies of the lending institutions active in the primary mortgage market. As an illustration, if these agencies make it known that they will only purchase paper which reflects an eighty percent (80%) loan to value ratio, the lenders with whom they deal will only make loans that reflect such loan-to-value ratios.

Should the federal government find it necessary to combat inflationary pressures in the marketplace, it can exert some influence through these three agencies. These quasi government corporations can increase the requirements of the paper they will purchase (e.g., higher interest rates, higher loan-to-value ratios) to tighten credit and money supply. They can also lower these requirements to make money and credit more readily available.

In view of the increasingly technical nature of mortgage loan activity, it should be clear that the successful real estate licensee must be a person who, in addition to possessing many marketing skills, must also possess a sound understanding of the factors affecting money and credit supply in the marketplace in which he/she or she operates.

Loan Transactions

Some real estate licensees specialize in limited areas of real estate activity, as we pointed out in chapter one of this book. Some licensees, rather than dealing with buyers and sellers of real property, choose to deal solely with borrowers and lenders who are concerned with loans secured by real property. Such real estate licensees are known as loan brokers, mortgage brokers, or mortgage loan brokers. Such licensees broker “paper” (promissory notes and security devices) rather than real estate. They assist borrowers and lenders in two ways. Either they help create new or they assist in the resale of existing loans.

To correct certain abuses which have arisen, the California State Legislature has found it necessary to enact laws for the protection of the investing public. Articles 5 and 7 have been added to the Real Estate Law controlling the activities of persons who engage in transactions in trust deeds and real property sales contracts, and incorporating into the Real Estate Law those provisions formerly set forth in the Civil Code under the designation of “Real Property Loan Brokerage Law.” These articles are detailed and comprehensive.

Article 5: Transactions in Trust Deeds and Real Property Sales Contracts (Land Contracts)

Article 5 is part of a legislative package enacted in 1961 to prohibit or rigidly control transactions in real property sales contracts and trust deeds which were characteristic of the “Ten Percenter” transaction (i.e., lender takes 10% in fees) that resulted in widespread losses to the investing public in the 1950’s and 1960’s.

The law does not apply to the negotiation of a loan nor to the sale or exchange of a trust deed by a real estate licensee in connection with a real property sale or exchange transaction negotiated by the licensee.

It does apply to anyone who engages as a principal or real estate licensee in the business of brokering mortgage loans for buying from, selling to or exchanging deeds of trust with the public. It also governs the broker who makes agreements with the public for the collection of payments or the performance of services in connection with deeds of trust. A broker may not service (collect payments, etc.) a trust deed or sales contract without the written authorization of the borrower or lender of the funds or the holder of the contract of sale.

A broker is not permitted to accept funds except for a specific, identified purchase or loan transaction or the broker must own the note or contract to be sold or must be a party to an unconditional written contract obligating the broker to purchase a specific note or contract.

Either as principal or agent, licensee may not retain funds for more than 60 days without written authorization to do so from the purchaser or lender, and such authorization must provide that no interest will be paid on the retained funds.

“Any real estate licensee who undertakes to service a promissory note secured directly or indirectly by a lien on real property or a real property sales contract, shall have a written authorization from the borrower or lender or holder of the contract.

When a licensee negotiates a trust deed loan, he/she must cause the trust deed to be recorded in the name of the lender or nominee, and not in the name of the licensee, before the funds are released, except where the lender gives written consent for release. If prior release is so authorized, the licensee shall record the trust deed or deliver it to the beneficiary with a written recommendation to record it immediately, within 10 days after a release.

Where a licensee sells, exchanges or negotiates the sale or exchange of an existing trust deed or sales contract, he/she shall cause a proper assignment to be executed and recorded, naming the purchaser or nominee as assignee, within 10 working days after funds are received from buyer or after close of escrow, or he/she shall deliver such contract or trust deed to purchaser with a written recommendation that an assignment be recorded immediately.

The advertising, distributing or broadcasting of any false or misleading statement, or the indication of any specific yield except the interest rate specified in the note and the discount from the principal balance at which it is being offered for sale, is forbidden.

The practice of giving or advertising any premium, gift or other thing of value as an inducement to make a trust deed loan or buy a loan or sales contract, is prohibited.

Article 7: Loan Broker Law

Mortgage loan broker: is a person holding a real estate broker's license who specializes in loans and charges a commission for making or selling a loan. The real estate law has long required the licensing of one who negotiates a loan secured by real property for another for compensation. Article 7 is referred to as the Real Property Loan Law and the Mortgage Loan Broker Law and applies to loans secured by first trust deeds under \$30,000 and by junior trust deeds under \$20,000.

The mortgage loan disclosure statement, also often referred to as the mortgage loan broker's statement, is at the heart of the real property loan law. Its purpose is to provide a prospective borrower with information concerning all salient features of a loan to be negotiated for the borrower (trustor). A real estate licensee, negotiating a mortgage loan subject to Article 7, must present a completed broker loan disclosure statement to the prospective borrower and obtain the borrower's signature on the statement prior to the time that the borrower becomes obligated to complete the loan. The real estate licensee must furnish this disclosure statement to the borrower regardless of the amount of the loan negotiated. In addition, the licensee must certify in the statement that the loan in question is in compliance with the provisions of Article 7. The form must also be signed by the loan broker or his/her agent. If the licensee is negotiating a loan to be made by an institutional lender, (banks, savings banks and life insurance companies) and the licensee does not charge the borrower a commission in excess of 2% of the principal amount of the loan, a mortgage loan disclosure statement is not required.

The form of the statement must be approved by the Commissioner. The Commissioner has, by regulation, established an approved form of the statement in Section 2840 of his/her regulations.

Contrary to general belief, the borrower's credit rating does not appear on the statement. A true and correct copy of the statement must be kept on file by the broker for four years from the date the instrument was signed by the borrower.

In the Real Estate Commissioner's Regulations, we learn that publication, distribution or use of advertising containing any of the following shall be considered to be false, misleading or deceptive: The use of terms such as "guaranteed," "insured," "secured," "bonded," "sure," "positive," or other terms relating to the security of funds of lenders or purchasers without fully explaining the extent or conditions to which such funds or rate of return are secured; or any statement relating to an absence of loss to lenders or purchasers without stating the period of time such statements cover.

The fraudulent act of working with a buyer and seller to increase the selling price to raise the amount of the loan is conduct that will be disciplined by the Real Estate Commissioner under Paragraph #10176 which states that "any other conduct which constitutes fraud or dishonest dealing" is grounds for disciplinary action.

Commissions and Other Charges When Limits Apply

A real estate broker negotiating mortgage loans subject to Article 7 is limited by law in the amount that may be charged as commission for arranging the loan and as to the costs and expenses of making the loan. These limitations do not apply in the case of a first loan with a principal of \$30,000 or more nor to a junior loan the principal of which is \$ 20,000 or more.

Legal Limits

The commission maximum for loans subject to Article 7 are as follows:

- ▣ First trust deeds (under \$30,000)
- ▣ 5 percent of the principal of a loan of less than 3 years.
- ▣ 10 percent of the principal of a loan of 3 years or more.
- ▣ Second or other junior trust deeds (under \$20,000)
- ▣ 5 percent of the principal of a loan of less than 2 years.
- ▣ 10 percent of the principal of a loan of at least 2 years, but less than 3 years.
- ▣ 15 Percent of the principal of a loan of 3 years or more.

Charges Other Than Commissions

Costs and expenses of making the loan, including appraisal fees, escrow fees, notary and credit investigation fees (but excluding actual title charges and recording fees) charged to the borrower cannot exceed 5 percent of the principal of the loan, provided, however, that if 5 percent of the loan is less than \$390, the broker may charge up to that amount. Regardless the size of the loan, the borrower cannot be charged more than \$700 for costs and expenses, provided that in no event shall maximum amount exceed actual costs and expenses paid, incurred, or reasonably earned. The regulations of the Commissioner preclude the broker from charging, as part of the costs and expenses of making the loan, a fee which exceeds that customarily charged for the same or comparable service in the community where the service is rendered. It is most important to recognize that there is no circumstance where the charges billed to the borrower can exceed the actual costs incurred in obtaining the loan.



Advances on an Existing Loan

“With respect to a further advance on a note, the charges shall not exceed the charges for an original loan in the same amount as the further advance and made for a term equal to the remaining term of the note on which the further advance is to be made.”

Chapter 13 Summary

Secondary financing refers to loans that are subordinate to a first loan (i.e., second trust deeds, third trust deeds, etc.). Secondary financing is always involved with the homeowner's equity in the property. The higher the amount of equity, the greater will be the ability to obtain secondary financing. Most secondary financing comes from hard money **equity loans** and from sellers taking back a loan to assist the purchaser by lowering the down payment.

Under normal conditions, conventional loans are made with a lower loan amount, in relation to the appraisal of the property, than those which are government insured or guaranteed. This relationship between the amount of the loan and the appraisal of the property is known as a **loan to value ratio**.

A **seasoned loan** is one that has been in existence for a period sufficient for a loan payment history to show a normal method of payment for that loan.

Savings Banks account for the greatest share of home loans. They include both federally chartered and state-chartered banks. They are regulated by the Federal Home Loan Bank which lends money on the open market. These lenders are corporations that have their stocks traded by the major exchanges. Since they are accountable to their stockholders their goal is to increase profits.

The lenders who prefer to make long-term loans are savings banks and insurance companies. **Life insurance companies** prefer to make long-term loans on large, high quality properties such as large shopping centers.

Lenders that want to fund a project issue a **take-out loan commitment** often called a **take-out letter**. This letter assures both the contractor and the construction loan provider that the money is ready when the construction is complete.

One of the many advantages of **FHA financing** is lower interest rates than conventional financing because of the protections and insurance. FHA does not make loans. It insures loans made by lending institutions such as banks, savings and loan associations, life insurance companies, independent mortgage companies and state agencies. With FHA insured loans, the mortgage loan may bear interest at any rate agreed upon between the lender and the borrower.

The appraisal of the property made by VA is known as a **certificate of reasonable value** (CRV) and sets the maximum loan amount to the veteran. The veteran must intend to occupy the home.

The **gross national products** (GNP) in terms of dollar value is the sum of all goods and services produced, consumed, saved and invested by all elements in a nation.

A **mortgage loan broker** is a person holding a real estate broker's license who specializes in loans and charges a commission for making or selling a loan. Real estate law has long required the licensing of one who negotiates a loan secured by real property for another for compensation.

chapter 13 quiz

- 1. Which of the following defines a “mortgage loan”:**
 - a. An instrument that is used only in the exchange of real property.
 - b. A financial obligation which is unsecured but is used to buy a building.
 - c. A promissory note that is unpaid.
 - d. A loan secured with real estate.
- 2. Equity is best defined as the:**
 - a. Means of clearing a cloud on title.
 - b. Purchase price of a property less the loans on it.
 - c. Fair market value of a property less the loans on it.
 - d. All of the above.
- 3. The basic protection of a lender on a purchase money second trust deed would be:**
 - a. Equity of the borrower.
 - b. Credit rating of the borrower.
 - c. Amount of a second trust deed.
 - d. The borrower’s ability to repay.
- 4. What is the nominal rate of interest you would pay on a conventional loan:**
 - a. Interest with discount points so it will be more than the simple interest rate.
 - b. The maximum amount of interest allowed by law.
 - c. The legal rate of interest.
 - d. The amount of interest agreed upon in the contract.
- 5. A note that is paid in full with equal payments is called:**
 - a. A straight note.
 - b. An amortized note.
 - c. A prime loan.
 - d. Void.
- 6. A principal lender for financing the purchase of residential property is:**
 - a. Savings banks.
 - b. Commercial banks.
 - c. Insurance companies.
 - d. Federal National Mortgage Association.
- 7. Mr. Davidson is building an eight-unit apartment and is financing the construction through a local mortgage company. The terms of financing provide that funds are to be released to him at various stages of construction. Under the terms, money released would be referred to as:**
 - a. Sight drafts.
 - b. Obligatory advances.
 - c. Acceleration payments.
 - d. Mechanics’ Liens.
- 8. The lowest rate of interest given by banks to their best customers is called?**
 - a. Discount rate.
 - b. Prime rate.
 - c. Equity rate.
 - d. Conventional rate.
- 9. If a person borrows money to purchase a personal residence, the loan most likely would be insured by:**
 - a. VA
 - b. FHA or private mortgage insurer.
 - c. Federal National Mortgage Association, Federal Home Loan Mortgage Corporation and Government National Mortgage Association.
 - d. The lender.
- 10. The purchaser of a residence was informed that the amortization period of his/her loan has recently lengthened. The method of financing used was most likely:**
 - a. Veterans Administration.
 - b. California Veterans Farm and Home Purchase Act.
 - c. Conventional.
 - d. Federal Housing Administration.



“It is a comfortable feeling to know that you stand on your own ground. Land is about the only thing that can’t fly away.”

- Anthony Trollope

CHAPTER 14: *appraisal*

Learning Objectives

An appraisal is critically important to the vast majority of all types of real estate transactions. The appraiser's opinion of value can make or break a sale or refinance transaction. Within this chapter, readers will learn the various steps involved in the appraisal process.

This chapter will also help agents and prospective agents better understand how property values are determined. Income property analysis and the methodology used by appraisers is discussed in detail. Readers will learn about the importance of choosing the latest sales comparable properties as used by appraisers prior to determining a property's estimated current value.

key terms

Accrued Depreciation	Engineering Method	Plot Plan
Age Life Method	Exchange Value	Progression
Appraisal	Foundation Plan	Quantity Survey
Breakdown Method	Functional Obsolescence	Reasonable Value
Cap Rate	Functional Utility	Regression
Certified Appraisal	Gross Multiplier	Rehabilitation
Comparative Unit Method	Highest and Best Use	Replacement Cost
Conformity	Improved Value	Reversionary Interest
Contribution	Letter Form Report	Scarcity
Deferred Maintenance	Market Approach	Short Form Report
Depth Table	Market Value	Sinking Fund Method
Diminishing Returns	Maturity	Speculative Value
Economic Life	Narrative Report	Straight Line Method
Economic Obsolescence	Net Operating Income (NOI)	Supply and Demand
Economic Rent	Physical Deterioration	Unearned Increment
Effective Age	Physical Life	Unit Cost In Place
Elevation Plan		

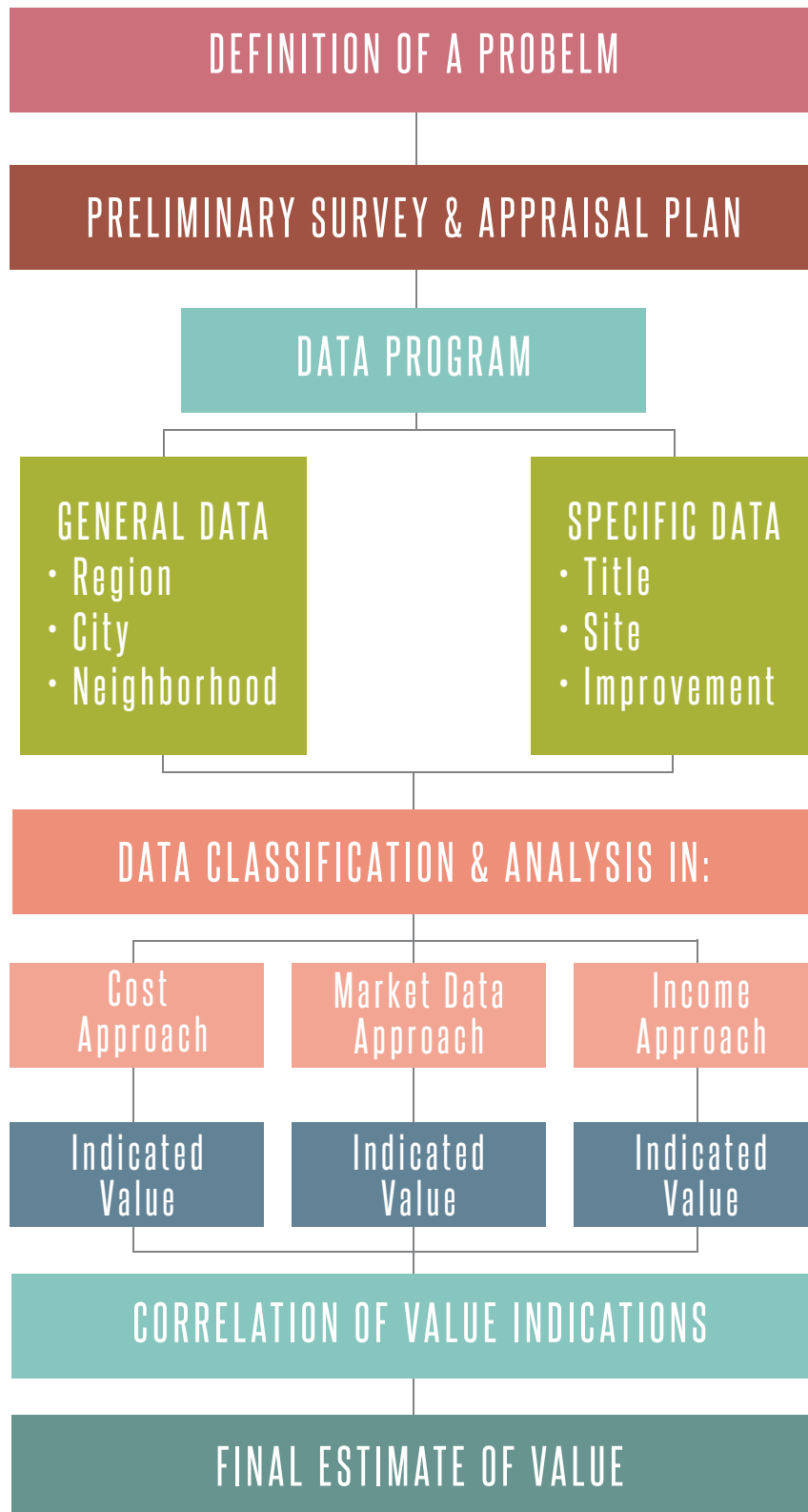
Definition of Appraisal

An **appraisal** or valuation is an estimate or opinion of value for a stated purpose as of a given date. It is not an exact science, rather it rests upon the appraiser's knowledge of appraisal techniques and his/her experience in the field. The first step in any appraisal is to determine its purpose. Investors have learned to rely more and more on the advice of professional appraisers rather than acquiring property by their own experience. Lenders demand it and will not loan on a property without an adequate appraisal. Government lenders also demand a certified appraisal before guaranteeing, purchasing or insuring a loan.

Making an appraisal is solving a problem. The solution requires interpretation, in terms of money, of the influences of economic, sociological, and political forces on a specific real property. Characteristics of real property differ widely. This does not mean, however that there is wide variation in the orderly procedure for appraisal problems. The best experience in the appraisal field has crystallized into the appraisal process.

This process is an orderly program by which the problem is defined, the work necessary to solve the problem is planned and the data involved is acquired, classified, analyzed and interpreted into an estimate of value. It is a dependable method of making a thorough, accurate appraisal in an efficient manner. It can also serve as the outline of the appraisal report.

The Appraisal Process



What a person pays for a property has nothing to do with its appraised value unless the property is new. The appraiser must be independent of the owner's thinking and must determine the value as of a given date.

Purposes and Uses of Appraisals

1. Transfer of ownership of property:

- An appraisal assures the seller that he/she is receiving a fair market value if he/she sells at the appraised value.
- The listing agent needs an estimate of value of the property before accepting a listing from the owner. Generally, an owner overvalues his/her property.
- When an exchange is involved, appraisals tend to balance the opinions of value formed by the parties.
- Valuations are often necessary for the distribution of estate properties among heirs.

2. Financing and credit:

- ▢ Appraisal of the property is used as security for the loan.
- ▢ Appraisal for taxation purposes.
- ▢ Condemnation actions.
- ▢ Insurance purposes.
- ▢ Miscellaneous appraisals.

3. The purpose for which the appraisal is being done, under certain circumstances, can affect the value estimate:

- ▢ Catastrophic damage.
- ▢ Fair rental value.
- ▢ Inheritance and gift tax.
- ▢ Fraud cases.
- ▢ Division of estate in wills, divorces, or rival claimants.

4. Lease valuations:

Lessor's interest consists of his/her rights to the income established in the terms of the lease contract. This factor is capitalized to a value of the lessor's interest. At the term of the lease contract, both the land and building where both are present, will revert to the control of the lessor. This indicates they will be reflected in an estimate of the lessor's interest in the property. The **reversionary interest** in the land, building, and the value of future rental income are all taken into consideration in an appraisal

Types of Appraisal Reports

The appraiser would be most concerned about directing his/her appraisal efforts to the date his/her client, buyer or seller would sign the agreement to purchase the property being appraised. The appraiser must give the report only to the employing client. The report will be furnished in one of three forms.

1. **Letter form report:** This type of report is generally used when the client is familiar with the area and supporting data are not necessary. It consists of a brief description of the property, the purpose of the appraisal, the date of the value estimate, the value conclusion, and the signature of the appraiser.
2. **Short form report:** This type is generally used by lending institutions. It consists of simple check sheets or spaces to be filled in by the appraiser. It varies from one-to-four pages in length. It utilizes comparable recent sales in the area, called comps. It is used for a client who is familiar with the neighborhood.
3. **Narrative report:** This type is the longest and most complete report. It includes all pertinent information about the area and the subject property, as well as the reasons and computations for the value conclusions. It includes maps, photographs, charts, elevation, foundation, floor and plot plans. A **foundation plan** is the plan which discloses features including piers, footings, and columns. A **plot plan** includes lot dimensions and improvements drawn to scale and in proportion to boundary lines. A **floor plan** includes all dimensions of interior and porch spaces. An **elevation plan** depicts the architectural style by a drawing from the north, south, east, and west sides of the building. It is written for court cases and out of town clients who need all the factual data.

Nature of Value in Appraising

Value is a word of many meanings. Because the word has so many different applications, it cannot be defined simply. One very common definition is: "Value is a relationship between the thing desired and the potential purchaser." Relationship is the key word in this definition. It indicates that the value of a thing relates to something outside the thing itself. The value of a home is established by what interested purchasers are willing to pay. This leads to another definition of value: "Value is in the eyes of the beholder," implying that the value of a thing is relative to the needs, desires, and purchasing power of the individual. It, in the "eyes of the buyer," is subjective in nature.

An object cannot have value unless it has utility meaning it must arouse the desire for possession and have the power to give satisfaction. **Functional utility** is the sum of a property's attractiveness and usefulness. These characteristics are found more properly in the property itself rather than in the minds of the occupants.

An appraiser's interpretation of value contains the elements of utility, scarcity, demand and transferability. It should be noted that these elements are factors not contained within the real property but are outside factors depending on the desires of man. They are said to be extraneous factors.

Elements of Value

The four elements of value are utility, scarcity, demand, and transferability. No one of these alone can create value. All must be present to maintain value.

Utility: This element arouses the desire for possession and gives satisfaction. A new well-designed home in a good neighborhood possesses a great degree of utility.

Scarcity: If an object is useful, but in scarce supply, its value will increase. Overbuilding of homes to the point where there is an oversupply on the market is a form of economic obsolescence that will result in lower values.

Demand: There must be demand for an object for it to have value. Utility creates demand. However, demand, to be effective, must be implemented by purchasing power.

Transferability: To be marketable, and therefore have value, the title or possession of an object must be transferable. Non transferable property would be like the Washington Monument, Brooklyn Bridge, or any property with a cloud on the title.

Memory key: Uncle Sam Demands Taxes

Cost is the past expenditure of dollars for the improvement of residential real property. It should be noted that cost is not one of the essential elements of value. A home constructed twenty years ago at a cost of \$10,000 may have a present value of \$250,000 or \$300,000, depending on current market factors.

Another theory put forth by appraisers is that there are other significant forces influencing value. These four forces are: physical characteristics; social ideals (attitudes) and standards, economic adjustments and political regulations.

Value Designations

The definition of value can vary greatly according to the circumstances and the time in which it is used. In any definition of value there must be a distinction made between the two major classes of value:

Value in use is said to be a subjective value. The term subjective as used in this sense has the meaning, "peculiar to a particular individual." This type of value would be considered by an individual when he/she is purchasing a property to meet a use or need and is not primarily concerned with its value in a buy/sell transaction in the open market.

Value in exchange is said to be an objective value. The term objective as used in this sense has the meaning, "the use of facts without distortion by personal feelings." The market value of a property would be an example of value in exchange. A property might have one value in use but an entirely different value in exchange. For example, an industrial or commercial property would have a higher value when looked upon by a purchaser who has a specific use for which the property is well adapted, than its general market value established by square foot or front foot prices offered in the area.

Types of Value

The results of an evaluation or appraisal can vary widely depending on the purpose of the appraisal and the function for which the appraisal is to be used.

The purpose of the appraisal refers to the type of value the appraiser wishes to establish. The purpose may be to establish value for tax assessment, insurance, loan, or liquidation.

The function of an appraisal report might be to assist someone regarding lending or borrowing money for real estate investments, regarding buying, selling or leasing property, or for many other reasons involving real estate.

In defining an appraisal problem, the appraiser usually develops an understanding and distinction of the appraisal's purpose and its function that is acceptable to himself/herself and his/her client.

The following are but a few of the many types of value that can serve as the purpose of an appraisal:

1. Market value.
2. Assessed value.
3. Insurance value.
4. Liquidation value.
5. Mortgage loan value.
6. Reproduction value.
7. Investment value.

However, the major portion of appraisal assignments involve the estimate of market value.

Market Value

When speaking of the value of real property, generally the reference is to **market value**. Market value is also referred to as value in exchange or objective value since it is not determined by, nor subject to, the restrictions of an established project. It has been variously defined as follows:

“The highest price estimated in terms of money which a property will bring if exposed for sale in the open market, allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted.”

“The price at which a willing seller would sell and willing buyer would buy, neither being under abnormal pressure.”

Three types of value that are similar and within the concept of market value are:

1. **Reasonable Value:** This is the term used by VA appraisers in determining the loan value of a property being purchased by a veteran.
2. **Exchange Value:** Normally, the appraiser will arrive at a market value on each property involved in the exchange.
3. **Speculative Value:** Actually, a speculator will pay the normal market value for a property on which he/she is speculating.

Value - Cost - Price

Value can be distinguished from “cost” as well as “price.” Neither cost nor price is necessarily the same as value. The principal differences in these terms can be summarized as follows:

Value: the combined factors of present and future enjoyment or profit. It is an opinion or estimate based upon a thorough analysis of all available influencing factors.

Cost: represents a measure of past expenditures in money, labor, material or sacrifices of some nature in producing the commodity. While cost may be a factor upon which value is partially based, it need not be, as it does not control present and future value.

Price: is what one pays for a commodity, regardless of pressure, motives or intelligence of the seller or buyer. Usually it is the amount of money involved in a transaction. Whether we receive more or less in value than what we pay will depend on how sound our judgment is in the appraisal. Some factors that tend to cause price to differ from value are: favorable financing, distress sale, forced purchase, uninformed purchaser or seller, and high pressure salesmanship.

Basic Principles Affecting the Value of Real Property

The principles of land utilization are so deeply rooted in economics that an understanding of basic economic principles is required to properly appraise real property. The following economic principles are especially important in property valuation.

Supply and demand: Demand for a commodity is created by its scarcity and it is limited by the financial ability of people to satisfy their desires and needs. The greater the supply of a commodity available, the lower will be its value.

- Scarcity influences supply.
- Desire influences demand.
- Desire, to be effective, must be backed by purchasing power.

Change: Nothing remains static. The future rather than the past is of primary importance in estimating value. The appraiser must observe the stage of development which a neighborhood has reached and define the phase of its life cycle. In the life cycle of a neighborhood, appraisers identify three stages:

1. Integration (development)
2. Equilibrium (static state)
3. Disintegration (decline or decay)

Substitution: This principle affirms that the maximum value of a property tends to be set by the cost of acquiring a substitute property of equal utility and desirability.

- The value of a replaceable property tends to be indicated by the value of an equally desirable substitute property.
- The value of a property tends to coincide with the value indicated by the actions of informed buyers in the market for comparable properties.
- The cost of producing, through new construction, an equally desirable substitute property usually sets the upper limit of value.

Highest and best use: The available use and program of future utilization that produces the highest present land value. Maximum utilization of resources is another way of saying “highest and best use.”

It is the use that will provide the greatest return to the land, e.g., short blocks in a subdivision, will devote more land for street use. Long blocks are more economical in utilizing land.

When selecting land for development the developer often chooses suburban rather than urban land. The principal reason for this choice is in an urban area, the development has been completed. The land costs are higher. The zoning and utilization of the land has been well defined. Flexibility of uses is limited. In a suburban area, the development costs are lower; however, the developer has the freedom to select the type of development he/she or she feels best and is not confined into a “strait jacket” of preconceived city plan. The developer may plan self-contained communities, complete with shopping centers, recreational, school and church facilities.

The most profitable likely use cannot always be expressed strictly in terms of money.

Return sometimes takes the form of amenities. An open wooded area in a city, for example, may have its highest and best use as a park. The amenities of a private residence may outweigh the advantages of rental income available on the rental market. The location of a private residence is considered an amenity, e.g., a residence located in the center of other similar residences vs. the same residence located on a main street.

Surplus productivity, balance: There are four agents involved in the production of income. Real property by itself has little or no value. It is only when the other agents are applied that value develops.

1. **Labor** (wages): By law and nature, labor is the first agent that must be paid.
2. **Coordination** (management): Operating expenses such as utilities, supplies, repairs, taxes and insurance must be paid next.
3. **Capital**: investment in building and equipment.
4. **Land**: The remainder of the gross income goes to satisfy capital and land.

Productivity: Highest and best use is that use which is most likely to produce the greatest net return over a given period. Productivity is understood in relation to highest and best use, utility or use. It employs all four agents.

Increasing and decreasing (diminishing) returns: The application of larger and larger amounts of the agents in production will produce greater net income (increasing returns) up to a point.

After the point of maximum contribution of the agents in production has been reached, any further increase in number of agents will decrease the margin between the cost of the agents and the gross income they will produce, resulting in decreasing net income returns.

Example: An apartment produces a 10% return. An additional investment of \$50,000 in a swimming pool without a proportional increase in gross income would result in a decrease in the 10% rate of return on investment.

Also called increasing and decreasing returns, states that increasing an investment in one of the agents of production labor, management, land or building will reach the point where any added investment will decrease the return on the investment. As previously stated, increasing an investment in an apartment by adding a \$50,000 swimming pool that does not result in a corresponding increase in rents will lessen the owner's return on his/her investment. Increasing rents in a neighborhood above the comparative rates of competitive apartments will create vacancies and form another form of diminishing returns.

Contribution: This principle may be said to be the principle of increasing and decreasing returns as it applies to some portion of improvement. This principle would be applied in the feasibility study of a proposed modernization or remodeling project. Contribution can positively or negatively impact the value of a property. A new swimming pool may impact value more than its cost. On the other hand, asbestos, found in buildings constructed prior to 1953, would have a major negative effect on value. Older gas stations can be negatively impacted, because the underground storage tanks have created a toxic waste problem. Appraisers, always on the lookout for these negative elements of contribution, will not only include them in the final report, they will depreciate their appraisal by the amount calculated to eliminate the toxic waste in a **Toxic Waste Report** issued by a company in the business of cleaning up these conditions. The appraiser will also notify the proper authorities of the problem.

The appraisal manual defines **remodeling**: "Changing the plan, form, or style of a structure to correct functional or economic deficiencies."

Conformity: The principle of conformity holds that maximum value is realized when there is a reasonable degree of architectural homogeneity and where land uses are compatible. In a shopping center, this would mean that major stores occupy the center. In a residential neighborhood, this principle also applies to the income of the population in the area.

Example: When you have largely varied incomes in an area, those with the large income can afford to improve their property where those with a smaller income cannot.

To achieve its maximum value, land must be utilized in such a way as to conform to the existing neighborhood standard.

Example: Dwellings in a residential neighborhood should conform in size, age, condition, and style for maximum value. A neighborhood of single family residences would be adversely affected by the introduction of boarding houses. Owner-occupied properties certainly lessen the possibility of property turnover as this type of owner is rooted to the present circumstances. Maximum property value would be maintained for the long term by owner occupancy.

Zoning regulations and private restrictions implement and affirm the value of conformity in land uses.

A misplaced improvement (the wrong type of structure) is a direct violation of conformity. It is considered economic obsolescence.

Regression: This principle holds that if a neighborhood consists of dissimilar properties, the value of the better properties will be adversely affected by the presence of the properties of lesser value. Example: In a neighborhood of \$150,000 to \$180,000 properties, the value of a \$300,000 property tends to regress towards the value of the price level typical of the neighborhood.

Progression: This is the reverse of the principle of regression. It states that property of lesser value will be enhanced by proximity to better properties. For example: A \$150,000 property in a neighborhood of \$250,000 to \$300,000 homes might sell for more than \$150,000 because there are people who will pay a premium to live in a higher priced neighborhood.

Anticipation: Value is created by the anticipation of future benefits to be derived from ownership.

Value is not established by what a property sold for in the past nor its cost to create it.

Recent sales prices of comparable properties are indications of the present worth of what informed buyers anticipate the benefit of ownership would yield to them.

Influences on The Value of Real Property

The growth and decline of nations, regions, cities, and neighborhoods are brought about by four great influences:

1. **Physical or natural forces.** Physical influences on the value of real property are brought about by forces created by both nature and man. Climate, topography, natural boundaries of oceans and rivers, lakes, mountains, swamps, mineral resources, and fertility of the soil are all physical influences created by nature. Railroad rights of way, traffic arteries, inland waterways, airports, college campuses, city, county and state lines are all examples of physical influences created by man.
2. **Social ideals and standards.** Social influences are based upon custom, instinct and ideals. People are gregarious; they like to be together in whatever they do. The competition

for location, space and housing has its influence on the value of real property. Other population factors that influence value is family size, age grouping, birth, marriage, divorce, and death rates. Social and aesthetic standards such as desire for privacy or prestige, desire for recreation and amusement, educational and cultural opportunities, religious affiliations, and tastes in architectural styles all tend to influence the value of real property.

3. **Economic changes.** Economic forces which influence the value of real property include commercial and industrial trends, wage levels and employment trends, availability of money and credit, interest rates, tax burdens, inflation, and any other factors which influence purchasing power.
4. **Civic and governmental regulations.** Civic and governmental influences on the value of real property include fire, health, and police protection, school systems and public recreational facilities. They also include government housing, guaranteed loans, rent control, and monetary policies which affect the free use of real property.

An economic trend is a series of changes brought about by a chain of causes and effects. The appraiser must be alert to past and present economic trends. He/she must consider the direction of the trend and its probable limit.

Physical Factors

There are many more items which should be investigated, according to the type of property appraised, and those mentioned above are but a few of the more obvious ones. Some specific items which are overlooked by the beginner are largely economic in their nature.

These have a tremendous influence on the desirability and usefulness of a property, which in the final analysis is really the measure of the worth of a property. Some of these influential factors are:

Action of the sun: The south and west sides of business streets are, as a rule, preferred by merchants because the pedestrian traffic seeks the shade side of the street in warm weather, and merchandise displayed in the windows is not damaged by the sun. This is referred to as **orientation**.

Amenities: These add value to residential income property as well as to single family dwellings. Proximity to markets, transportation, amusement and shopping centers, churches, etc., are factors of value. Certain locations will appeal to potential tenants and the rents will be higher in these than in similar buildings in different locations. Upgrades over the neighborhood standard are also considered amenities, such as granite counters in a kitchen when other homes have tile counters.

Location: It is said the three most important considerations in appraising the desirability of a property are location, location, and location. Though a bit exaggerated, location is important and is significant. Before a developer spends time and money developing a shopping center, the location comes into play. A neighborhood shopping center requires 5,000 to 10,000 population at minimum within a one mile radius. A community shopping center requires

30,000 population within a four-mile radius, and a regional shopping center requires 100,000 population within a six-mile radius to financially exist. It also requires a major triple “A” tenant to secure the financing to construct the facility and draw the largest number of shoppers. A one hundred percent location is said to be the best possible location in that city for that place of business.

Building restrictions and zoning: These sometimes operate to depress values and at other times to increase values. For example, there may be a vacant lot on a residential street which will sell for only \$50 a front foot for residence use but would sell for \$300 per front foot as an apartment site. Or, a vacant lot in a zoned area may sell for more per front foot as a business site because of the supply of business sites being restricted by zoning. Industrial areas, depending on size, would best be valued by the acre or square foot.

Character of soil: This is a factor in residential and in some classes of manufacturing properties. Whether sand, clay, silt, peat, chalk, loam, or another type of soil may be a consideration for a prospective buyer.

Conspicuousness: Largely a factor of publicity value and it can become of some importance to business depending upon advertising.

Corner influence: This is the value effect of location at or in proximity to the intersection of two streets. The estimated value resulting from such location or proximity is based on the use of the property. Commercial property achieves the greatest value from corner influence.

Cost of construction: This is subject to frequent adjustments to compensate for changes in the cost of lumber and other building materials, as well as the wage scale of carpenters, plumbers, electricians, painters and others. A thorough knowledge, or at least a very authentic source of current information on construction costs and fluctuations, is necessary for the appraiser.

Construction costs are classified as **direct** and **indirect**. A building permit is classified as indirect as it does not enter the construction of the building but is an overhead item. Direct costs could be the consideration of whether the land is hilly or flat (topography), the architectural type of home in demand by the purchasers in that area and if the highest and best use of the land would be to build a one or two-story property.

Example: It costs less to construct 2,000 square feet of living space in a two story house than a one-story house because there is half the foundation, half the lateral plumbing lines, half the roof area and half the heating ducts. These items are usually the costliest portions of a structure.

Directional growth: In any estimate of value, attention should be paid to the “city directional growth.” The city directional growth refers to the manner and direction in which the city tends to grow. Properties in the direction of growth in different sections of the city tend to increase in value, especially if the growth is steady and rapid.

Highest and best use: Another factor used in appraising. It means creating the greatest value for a lot by improving it with buildings or using it in a way which will produce the greatest net income. A lot value may be depreciated by the wrong improvement.

Indexes: Cost of Living and Cost of Construction index figures are good indications of cost and value fluctuations. If a house cost \$8,000 to build when the construction index figure was 100, then the same house would cost \$12,800 when the index rose to 160, or \$7,200 if the index had dropped to 90. Likewise, if a property was worth \$20,000 when the Cost of Living index was at 100, then it should be worth \$40,000 (disregarding depreciation) when the index figure rose to 200.

Plottage This is the added value of several parcels of land when brought under one ownership, making possibly a higher utility than could be found for the parcels when considered separately.

Size: The width and depth often determine the possibilities and the character of use. A series of factors called a **depth table** is often used to estimate relative value of commercial lots which vary from a normal depth. The depth table rule is stated as the 4 3 2 1 rule. This means that the first 25% of the depth contains 40% of the value, the second 25% contains 30%, the third 25% contains 20%, and the fourth 25% contains 10% ($40\% + 30\% + 20\% + 10\% = 100\%$ of value). There are two general rules of behavior concerning square foot and front foot units of value:

1. As the depth increases the front foot value increases, however, the square foot value decreases.
2. As the depth decreases, the front foot value decreases; however, the square foot value increases.

Shape: Parcels of land irregular in shape usually cannot be developed as advantageously as rectangular lots.

Thoroughfare conditions: The width of the street, traffic congestion, and the condition of the pavement affect the value of those properties fronting on the street.

Unearned increment: This is an increase in the value of property, not anticipated by the owner, due primarily to the operation of social or economic forces rather than to the personal efforts, intelligence, skill or initiative of the owner. Usually, but not necessarily, this is applied to land.

Depreciation Concepts

Depreciation from the viewpoint of the appraiser may be defined as:

1. Loss in value from any cause whatever.
2. A loss from upper limits of value.
3. An effect caused by deterioration and obsolescence.

Depreciation, to an appraiser, is actual. This is far different than the depreciation as viewed by an accountant. An accountant is interested only in the book depreciation of the property for income tax purposes, while the appraiser is interested only in the effect actual depreciation has on value.

In general, the value of an improvement may be said to depreciate from the moment of its conception. Eventually, its utility will cease entirely.

Depreciation makes a structure not only lack value, it can become a burden to the land. A residence, constructed in 1910 still standing on a lot that would be valued at \$100,000 if vacant, will reduce the value of the lot by the cost of demolishing the structure.

Depreciation is said to be “the inexorable parade to the junk heap.” Depreciation is the almost inevitable companion of an improved property over its economic life. It is never a deduction applied to the land, whether for appraisal or income tax purposes.

Economic life: The period over which a property will yield a return on the investment over and above the economic or ground rent due the land. The economic life of a structure should not be confused with its physical or chronological life. This is used to determine depreciation.

Physical life: The estimated period during which a physical thing may be capable of use if normally maintained. An apartment house may have a physical life expectancy of 100 years. However, its economic life expectancy may be only 40 to 50 years. NOTE: Economic life can never exceed physical life, and is generally shorter than physical life.

Accrued Depreciation

In appraising, **accrued depreciation** is defined as the actual loss of value existing in a property at a given date. Accrued depreciation has already occurred.

Accrued depreciation may be classified as curable or incurable.

Curable depreciation refers to items which are customarily repaired or replaced by a prudent owner. A curable depreciation item is one which may be cured on the date of valuation, which if immediately accomplished, would put the building in optimum condition. Examples of curable items of depreciation would be the replacement of a worn-out roof or inadequate or old-fashioned fixtures.

Incurable depreciation refers to those items of depreciation that are not economically feasible or profitable to replace or cure on the date of appraisal. Examples of incurable depreciation are major structural changes to foundations or to girders or extensive changes in architectural design.

Causes of Depreciation

Depreciation is best defined as a loss of value from any cause whatsoever. There are three major causes of depreciation:

1. Physical deterioration
2. Functional obsolescence
3. Economic obsolescence

Physical deterioration: A loss of value brought about by wear and disintegration, use in service, and the action of the elements, constitutes physical deterioration. It is said to be inherent to the property. Physical deterioration may result from:

- Wear and tear
- Negligent care, sometimes defined as deferred maintenance
- Damage by dry rot, termites, or other infestation
- Severe changes in temperature
- Action of the elements

Physical deterioration usually occurs first in the lower price ranges. They are usually constructed with cheaper materials and consequently will deteriorate faster than costly structures.

Deferred maintenance: A form of physical deterioration. When normal maintenance has not been performed and a lump sum expenditure is required to correct deficiencies in paint, screens and landscaping, this lump sum amount is classified as deferred maintenance and is deducted from the building value.

Rehabilitation: Necessary maintenance, or accrued maintenance. Regardless of the term of reference, what is meant is the cost to restore the property to the competitive level. This does not mean the anticipation of repairs in advance, or sustaining an unnecessarily high degree of maintenance. It simply means necessary repairs.

Functional Obsolescence: Probably the greatest cause in the decline in a property's value is the passage of its physical life. This includes a loss of value brought about by such factors as over capacity, inadequacy and changes in the overall design of the property. It is also defined as the inability of a structure to perform adequately the function for which it is currently employed. It, too, is said to be inherent to the property (within property lines). It is usually "curable."

There are times when functional obsolescence could be termed incurable.

Example: An improvement that has over capacity and super adequate facilities suffers a loss of value due to functional obsolescence that is incurable, e.g., a builder constructed an office building containing 100 separate offices for lease. When he/she attempted to sell the property, he/she discovered that he/she could not recover his/her cost of construction because the area would presently support only 20 additional office units, and that he/she had installed oversized, heating, cooling, plumbing and electrical systems.

Functional obsolescence may result from:

- ▢ Poor architectural design.
- ▢ Lack of modern facilities.
- ▢ Out of date fixtures.
- ▢ Changes in style of construction.
- ▢ Changes in construction methods and materials.
- ▢ Changes in utility demand (one car garage, one-bathroom home).
- ▢ Massive cornices.

Example: A building's corridors are twelve feet wide. In today's market, over six feet of width is considered functionally obsolete space. The appraiser's primary measure of the efficiency of an office building plan is the ratio of net rentable area to gross floor area. The net rental area of office space is considered as the rental space between the outside wall and the corridor wall. Extra wide corridors reduce net rentable space, thus the value.

Improperly locating a residence on its lot is a factor inherent in the property itself. Hence, the value loss resulting would be identified as functional obsolescence.

Economic Obsolescence: This cause of depreciation is said to be extraneous to the property. That is, it is a loss of value caused by an effect outside the property and not by something within the property itself.

Economic obsolescence is also referred to as social obsolescence and defined as impairment of desirability arising from economic forces such as changes in highest and best use legislative enactments, and changes in supply and demand relationships. It is the most difficult kind of value loss for the owner of the affected property to correct. Economic obsolescence may result from:

- ▢ Misplacement of improvements.
- ▢ Over improvement of property.
- ▢ Zoning and legislative restrictions.
- ▢ Detrimental changes in supply and demand.
- ▢ Proximity to noxious odors and fumes.
- ▢ Proximity to freeways, major highways, airports.
- ▢ Major industries leaving an area.
- ▢ Unreasonable tax rates.
- ▢ Over supply of like properties.

Methods of Estimating Accrued Depreciation

Accrued depreciation is the sum of the depreciation that has occurred since the building was first constructed. There are five general methods of estimating accrued depreciation:

- ▢ Indirect Methods
 1. Capitalized income
 2. Market
- ▢ Direct Methods
 1. Straight line (age life)
 2. Engineering (observed condition)
 3. Breakdown

Indirect methods: The capitalized income and market methods require that the present value of the property be determined first. After the present value of the property is determined, the cost of reproducing the property new at current costs is calculated. The current value is then subtracted from the reproduction cost new and the remainder is defined as accrued depreciation.

Example:

Reproduction Cost New	\$50,000
Less Current Appraised Value	<u>\$35,000</u>
Accrued Depreciation	\$15,000

The straight-line method (age-life) assumes the value declines in equal amounts of depreciation each year until it reaches zero. Using this method, a building with an economic life of 50 years would depreciate 1/50th in value each year. Note that depreciation on a 50 year life can also be expressed at 2% a year (100% divided by 50 years = 2% per year). This is the method most used by appraisers.

Example:

A property has a value of \$100,000. The land is valued at \$40,000. The building has a total economic life of 40 years. Its present age is 12 years. What is the accrued depreciation using the age life method?

\$100,000 property value	
<u>\$40,000</u> less land value	$\$60,000 \div 40 \text{ years} = \$1,500 = 1 \text{ year}$
\$60,000 building value	$\$1,500 \times 12 \text{ years} = \$18,000 = \text{total accrued depreciation}$

In some cases, when using the **age life method**, an appraiser will use an age other than the actual age of the building. This is known as the effective age. **Effective age** is defined as the number of years of age that is indicated by the condition of the building. If a building has had better than average maintenance, its effective age may be less than the actual age. If there has been inadequate maintenance, it may be greater. A 50 year old home may have an effective age of 20 years after rehabilitation.

The **engineering method** (observed condition) of estimating accrued depreciation differs from age life. Depreciation is applied to the individual parts of the structure foundation, walls, floors, plumbing, heating, etc. This procedure obviously requires a more thorough inspection and examination of the property. Also, the appraiser must make individual estimates of depreciation before arriving at an estimate for the building.

The **breakdown method** is a refinement of the engineering method. In this method, not only are construction components recognized, but also the components of depreciation, physical deterioration, functional obsolescence and economic obsolescence are treated separately.

Accrual for Depreciation

Accrual for depreciation or future depreciation is the loss in value which has not yet occurred but will come and is of significance in the capitalization approach. In the income approach to valuation (capitalizing the net income) it is based on the remaining economic or useful life during which time provision is made for the recapture of the value of the improvements as they wear out.

In other words, an accrual for depreciation provides for a return of the investment in the building during its estimated useful life. It may be figured either by the “straight line” method, or by the “sinking fund” method.

The **straight line method** contemplates that a definite sum be written off or deducted from the income each year during the total estimated economic life of the building, to replace the building.

The **sinking fund method** contemplates an annual investment of a given amount in a compound interest bearing fund for the number of years of remaining useful life of the building, and provides for a lump sum return of the present value at the end of the economic life.

Analysis of data: After assembling all the information which can possibly have a physical, economic or functional effect on the property, it is necessary to consider it carefully for arriving at an estimate of value. This is the analysis of the property and the point where the seasoned judgment of the appraiser is employed to the fullest.

In truth, this is a determination as to the accuracy of the data, whether they have any influence on the value of a property and, if so, to what extent. This may be difficult in the appraisal of special purpose and investment properties, particularly if the appraiser lacks experience. However, the average broker or salesperson should be able to make an analysis of selling prices which is the sole basis of one of the approaches to value.

If the information is not accurate, then the opinion of value arrived at is also inaccurate. Ask yourself: Is that the actual selling price? Is the property sold in a comparable and equally desirable neighborhood? Was it a forced sale or a normal sale? Is the house equally desirable and useful as my appraisal house? The most important aspect is to be honest in the treatment of data, honest in your conclusions and honest with your client when he/she says, “How much is my property worth?”

Appraisal Methods

To **appraise** means to arrive at an estimate and opinion of the value of a property. Usually, an appraisal is a statement of the market value, or value for loan purposes, or value as defined by the appraiser, of a parcel of property as of a specified date.

The appraisal always determines the value of a whole property free and clear from any encumbrances. Should an appraiser be called upon to appraise a part of a property, an interest in the property or the value encumbered by a low interest loan, the appraisal of the whole property unencumbered by partial interests or money liens would be made first. After the appraisal, the value of the interest would be determined.

Method Considerations

There are four ways to approach a value estimate. These methods or types of approach are:

1. **Comparison:** A comparison is made as to price, value, utility and location in relation to other comparable property in the same or similar type neighborhood (**Market Approach**).
2. **Reproduction cost:** This approach computes the current cost of reproducing the improvements with an added value for the land, arrived at by comparison with other lands. Deductions are made for depreciation from any cause. In the mechanics of preparing the facts of the reproduction cost approach the process of bringing together the depreciated building value and the land value is identified as the summation step in the procedure.
3. **Replacement cost:** There is a theoretical difference between the “reproduction cost” and the “replacement cost” approaches to value. The “replacement cost” approach, i.e., replacing the property being appraised with an equally useful property without using exact materials used in the structure as it stands is the final estimate of the value if all else fails. The “reproduction cost” is defined as the cost of reproducing a new replica property based on current prices with the same or closely similar material.
4. **Capitalization:** Capitalization is the calculation of the present value of future benefits. The process simply converts income into value. Using this method on income property, the present value is established by considering the prospective future annual net income of the property. Capitalization converts this net income stream into an estimate of the present worth of the property. This is done by dividing the annual net income by an appropriate interest rate (cap rate). The interest rate referred to as the overall rate includes both the return on investment (net income) and the return of investment (the recapture rate.)

Example: If the economic life of the building is 25 years and the interest rate is 11%, you would add the depreciation rate 4% (equivalent to 25-year life) to the interest rate 11% to give the overall cap rate of 15%

If interest rates rise, new investors will require greater rates of return on invested capital. This means that properties with a fixed income that have that income capitalized by an increasingly higher rate of return (cap rate) would have the value of the property decrease. Conversely, when interest rates decline, the effect on income producing property value is to have it increase. As compared to stocks and other forms of investing, real estate has a slower capital turnover.

Frequently, the appraiser will use all three methods in appraising certain properties. No single approach by itself can always be counted on to produce reliable estimates of value. Each parcel of real estate differs in some respect from other properties. Various appraisals are made for different purposes and the use to which the property is put will add greater weight to a specific approach.

Though it is incumbent upon the appraiser to use all methods of appraisal to complete and validate their work, the final solution is always one of judgment. Never does an appraiser justify the solution by combining the answers arrived at using each method independently and averaging the total.

Types of Property

Basically, real property is divided into three classes:

1. Non investment
2. Service
3. Investment

The appraisal techniques will be applied as follows:

Non investment property: Here we have the single-family dwelling and the vacant lot. The land can be appraised only by comparison. The dwelling, however, can be appraised by cost and comparison approaches, with the greatest weight on the comparison approach.

Service property: Any property which does not fit the characteristics of other classifications is known as a service property. Such properties are churches, schools, and public buildings. There is no active sales market to provide an indication, thus the comparison approach cannot be used. There is no net income to capitalize, eliminating the use of the capitalization approach. Therefore, the only method remaining is the cost of reproduction approach.

Investment property: This includes any property producing income such as apartments, stores, offices, etc. All three approaches - cost, comparison and capitalization - can be used. The greatest weight, however, is given to capitalization since the prime motive for acquisition is to receive income.

The Comparison Approach

Known as the market data or comparative analysis approach, the comparison approach is the oldest method of appraising known. This method is particularly adaptable for use by real estate brokers and salespeople. It lends itself readily to the appraisal of land, buildings and residences which have a high degree of similarity and amenities. It is also a check against the other methods of appraising. This approach concerns itself with today's immediate market. The value achieved has nothing to do with what an owner originally paid for a property. The appraiser uses recent sales of comparable property by checking public records and by directly acquiring this information from buyers and sellers of comparable property. Appraisers also look at multiple listing board data. The listed prices tend to set the upper limit of value because sellers usually ask for more than they expect to receive. Selling prices tend to set the market value of similar properties.

In the determination of value within a given neighborhood by an appraiser, offers to purchase property received by brokers will tend to set the floor of what prices can be expected in the neighborhood. Sellers list high whereas buyers generally offer to pay less than they might have to agree to pay. In a bargaining circumstance, asking prices to establish the upper limit for prices in the area while offers to purchase will set the lower limit to which prices might fall.

As stated in the basic textbook of the American Institute of Real Estate appraisers, "the primary concern in the appraisal analysis of any residential property is its degree of marketability, or acceptability when offered for sale." Marketability and acceptability by the public is the ultimate test of style and design (Functional Utility.)

Since 99% of comparison properties are residential improved property or vacant land, it is important to understand the definitions of the following real estate terms.

A **residential neighborhood** is best defined as a grouping of individuals with similar **social** and **economic status**. Another definition is: "A **homogenous grouping** of individuals within, or as part of a community." Neighborhoods are not fixed in **character**, they are always changing. The boundaries of a neighborhood vary in size, but they are generally homogeneous in some respect. These boundaries are both natural and economic. Examples: A **natural barrier**, such as a hill, or a man made barrier, such as a main traffic artery or a distinct change in type of land use or a change in the character of inhabitants. A **unified area** with a homogeneous population that has a community of interests. These boundaries are used by appraisers.

The procedure used in the comparison approach is to assemble data concerning sales and other market data of comparable properties.

The greater the number of good comparisons used, the better the conclusions which may be drawn from them. The approach assumes that property is worth what it will sell for in the absence of undue stress, if reasonable time is given to find a buyer. For this reason, the appraiser should examine other sales and transfers to ascertain what influences may have affected sales prices. Obviously, the more active the market (the higher the number of sales) the more valid will be the appraisal.

Proper comparisons between properties should be based on actual and thorough inspection of such properties. For nearly comparable properties, penalties should be assessed for poor repair, freakish design, nuisances, etc. Conversely additional values should be allowed for attractive view, special features, better condition, higher quality of materials, landscaping and the like. Unless the sales being compared are of recent date, consideration also must be given to adjusting value in keeping with the general economic worth of the dollar as of such dates. The average of the adjusted price for all selected comparable sales usually provides a measure of value for the property being appraised.

A typical layout is as follows:

Date	Property	Sales Price	Adjustments	Value
11/01/15	221 Elm	\$229,250	has patio (-\$250)	\$229,000
10/04/15	19 Oak	\$228,900	none	\$228,900
07/05/15	497 Oak	\$229,100	none	\$229,100
08/08/15	24 Peach	\$228,750	repairs needed (+\$200)	\$228,950
10/09/14	26 Oak	\$227,060	time adj. +2%	<u>\$231,600</u>
			Total	\$1,147,550

$\$1,147,550 \div 5 \text{ properties} = \$229,510.$

Rounded off the average value is \$229,500

Note that adjustments are added or subtracted from the comparable to determine value of the subject property (i.e., comparable has a patio that is estimated to be worth \$250 more than the subject, therefore \$250 is deducted from the comparable's sale price).

The comparison of unimproved land first requires a site analysis. In the matter of site analysis, excess land is land which exceeds that which is needed to serve the existing improvements on the site, or identified with sites which are larger than other marketable lots in the area, or such that it may or may not be an addition to the estimated value of the site.

Cost Approach

When a property is new, or when there is no active market for a property, market data is lacking or it has no monthly income to consider, the appraisal approach most likely to be employed would be the cost approach. In its simplest form, the cost approach determines the cost to reproduce the improvements, subtracts the depreciation, and adds the value of the land. The cost approach is an estimate of the investment which would be required to duplicate a property in its present condition. Ordinarily, since people will not pay more for a property than it would cost to replace the structure at the time, or to obtain an equally satisfactory substitute property, the cost approach tends to set the upper limit of value. This approach is almost never used on old structures with functional deficiencies.

Though weighted heavily with a depreciation factor based upon the current age, a fire insurance appraiser will use the cost of reproduction approach to obtain the replacement value of a property.

The first step with this approach is to make an independent estimate of the value of the land. This is always the current market value of the land as if vacant and available now for improvement to its highest and best use. The comparison approach is used in this valuation.

Note: When the property has been improved with trees, shrubs, lawns, fences and sidewalks, the appraiser would always value these items separately. These items may be considered as part of the improvements or as part of the earth itself. However, when comparing different sites, they must be treated as separate items for comparative value. The appraiser would make a dollar adjustment for the value of landscaping, fences and sidewalks.

The second step is to estimate the replacement cost new of all improvements on the property. Such cost figures are obtainable from local contractors or from numerous services which publish them.

Building costs will vary considerably based on the efficiency of the builder and the amount of profit which is included in such costs. There is a great variation also in the quality and design of structures so that, unless the appraiser is experienced in such matters, his/her estimates of value may be inaccurate. Often a square footage average cost of new construction is the tool used.

The third step in the cost approach method is to determine the existing depreciation of the property. The amount must be deducted from the replacement cost new to determine the present value of all improvements. The difficulties of estimating depreciation correctly tend to increase with the age of the property. Determining how much depreciation has occurred requires skill, experience, and good judgment. A value determined by using the cost approach is no more reliable than is the estimate of depreciation.

The last step is to add the estimated value of the land to the remaining depreciated value of the building to arrive at the total value of the property. This is referred to as the **improved value**.

Reproduction Cost

Land value today (comparison)	\$210,000
Building cost new today	\$540,000
Physical loss (10 yr.) 50 yrs. Life	\$108,000
Functional loss 10% of new	<u>+\$54,000</u>
Total depreciation	\$162,000
Remaining value of building	+ <u>\$378,000</u>
Total value of the property	\$588,000

Methods of Determining Cost New

There are several methods of determining the cost of improvements new (second step above). They are:

Quantity survey: This is the most accurate (and most difficult) method and involves detailed estimates of the quantities of raw materials used, such as lumber, brick, cement, etc. The price of such materials and the labor costs, added together, give an accurate and detailed cost of reproduction. This method is used by most experienced estimators.

Unit cost in place: Estimating the cost of erecting each component part of the structure such as foundations, floors, windows, roofs, etc. These estimates include labor and overhead. The shape of a structure would influence the cost of construction.

Comparative unit method: The comparative unit method involves square and cubic footage. The actual cost of similarly constructed buildings is divided by the number of square or cubic feet arriving at a dollar amount per square or cubic foot. Obviously, the use of cubic foot over square feet to determine value will be more accurate. Using square or cubic footage is called the unit of comparison method. It is probably the easiest to use.

Square footage is calculated by measuring the maximum length by the width of a structure then subtracting any deviations from this space caused by indentations in the exterior walls. When using the number of square feet in your residential unit comparison method, it is assumed that ceiling heights are a constant height.

Cubic footage simply multiplies the square footage obtained by the height of the interior walls. A warehouse may contain varied numbers of ceiling heights. A warehouse is appraised for the number of cubic feet it has for storage.

Income (Capitalization) Approach

The income approach is concerned with the present worth of future benefits which may be derived from the property. This method is particularly important in the valuation of income property. The income method is also defined as the capitalization method (cap method). Capitalization is a procedure by which the value of a property can be estimated from the quantity, quality and durability of its net income. Inwood and Hoskold are well known in the field of appraising for the work they have done in perfecting the income approach to the valuation of real property in the late 1800's. The history of the property is not used. Only the anticipation of future income is employed.

Maturity - In the language of real estate professionals, a property is said to have reach "maturity" when the overall operation of the property is beginning to show a profit.

Management, though never overlooked by a professional appraiser, is the most likely item to be overlooked in the purchase of an income producing property. Good management begins as an assist to the appraiser before the property is purchased. Urbanization, technological development in building construction, and absentee ownership make good property management a necessity. Property management may be said to be twofold in scope:

1. Maintain the investment (income) in the property
2. Maintain the physical aspects of the property at a point of optimum efficiency and economy.

A good management company will return to the investor far more in savings than the cost of management. The purchasing power of labor and materials is returned to the owner in savings. The ability of the management company to maintain rents and lower vacancies, because of their advertising prowess, maintains high levels of income.

The Administrative Code of the State of California requires that a responsible person reside upon the premises and have charge of every apartment house in which there are 16 or more apartments. A good on premises manager creates a happy tenancy and a profitable investment.

Unless the purchaser of income property can recognize the existence of management as an expense in the operation of the property, he/she could easily overlook the matter. It should be considered prior to the purchase of a property. Good management includes a complete survey of the property and the surrounding area to indicate a demand for space, maximum rents available and other such items which should be made before acquisition. A professional appraiser would never establish a capitalization rate without including property management as an expense when arriving at the net income.

The important consideration in this approach is the net income which a fully informed person using good management is warranted in receiving during the remaining useful life of the improvement. There are three main steps used in the income approach: determining net income, capitalization rate, and capitalizing the income.

A net annual income is derived by deducting the total annual expenses from the annual gross income, after making proper allowances for vacancies and collection losses. Expenses should be realistic and include such items as management, real property taxes, services, utilities, insurance and maintenance. Debt service is never included in this list of expenses, as it has no bearing on operational costs. The appropriate gross income that should be used is the expected future gross income, also known as scheduled gross income. The gross scheduled is that income based upon all units being rented all the time. The realities are that there will be some vacancies and rent collection losses over the economic life of the property. Therefore, when you subtract a factor for vacancies and rent losses, the remainder is called **Effective Gross Income**.

Past income is not a consideration, except as it may be a guide to future income. Income forecasts should be based upon past and present income modified by foreseeable economic changes.

The expenses are classified as “fixed and operating”. **Fixed expenses**, such as taxes and insurance, seldom vary. Operating expenses tend to fluctuate. The result of gross income, minus expenses, is called **Net Operating Income**.

A selection is made of an appropriate capitalization rate. This rate is the rate of return which investors demand before they will be attracted to the investment.

Capitalization rates are often provided in reciprocal numbers. Numbers, when multiplied together, that have a product of one (1) are reciprocal numbers. Since a capitalization rate is always a fraction, its reciprocal will always be a whole number.

$$\text{Thus } 1 \div .08 = 12.5 \quad \text{Proof } 12.5 \times .08 = 1$$

The final step to be accomplished after having determined the net income and the capitalization rate is to capitalize the income. This is merely a mathematical calculation of dividing the net income by the appropriate rate.

Example: A net income of \$10,000 and a cap rate of 10% would result in a capitalized value of \$100,000.

$$\$10,000 \div .10 = \$ 100,000$$

This indicates that if the investor paid \$100,000 for the property, he/she would receive 10% on his/her capital investment.

$$\$100,000 \times .10 = \$10,000$$

Capitalization Approach Illustrated

A 10-unit apartment receives fair market rents of \$500 per month per unit. Indicated vacancy factor is 10%. Annual expenses include: management \$2,600, maintenance \$1,250, taxes \$4,500, insurance \$1,500, utilities \$900. Capitalization rate is 10%. Reserves for replacement of stoves & refrigerators is \$1,200.

Operating Statement

Gross Income Estimate (scheduled gross)			
(10 x \$500 = \$5,000 month x 12 = \$60,000)			\$60,000
Less Vacancy and Rent Loss (10%)			<u>\$10,000</u>
Effective Gross Income:			\$50,000
Expenses:			
Fixed Expenses:			
Taxes	\$4,500		
Insurance	<u>1,500</u>		
			\$6,000
Operating Expenses:			
Maintenance	\$1,250		
Management	2,600		
Utilities	<u>900</u>		
			\$4,750
Replacement stoves & refrigerators			<u>\$1,200</u>
Total Expenses:			<u>\$11,950</u>
True Net Income			\$38,050

Selection of Capitalization Rates

The selection of capitalization rates is one of the most important tasks of the appraiser. Rates must be selected with utmost care based upon market experience. A variation in the rate can produce a wide variation in the resulting value. For example:

<i>Net Income</i>		<i>Rate</i>	=	<i>Value</i>
\$6,000	÷	.06	=	\$100,000
\$6,000	÷	.08	=	\$75,000

This illustrates a basic rule of capitalization rates. Given a fixed income amount:

The higher the rate, the lower the value; the lower the rate, the higher the value.

Rate selection (by comparison) - The appraiser collects data from numerous examples of property sales in the open market. He/she then determines the rate of return developed by each property and establishes an average overall rate acceptable to typical investors. A typical analysis would be:

<i>Comparable Property</i>	<i>No.1</i>	<i>No.2</i>	<i>No.3</i>	<i>No.4</i>	<i>No.5</i>
True Net Income	\$10,500	\$10,160	\$10,400	\$11,000	\$10,000
Selling Price	\$125,000	\$120,000	\$122,000	\$130,000	\$127,000
Relative Cap Rate	.084	.0847	.0852	.0846	.079

Rate selection by band of investment theory: The band of investment method is a combination of mortgage and equity rates which market data discloses as existing on comparable properties. The rate developed is a weighted average. The weighting consisting of the percentages of value using the mortgages and the equity of the owner. For example: an apartment house has the following mortgage and equity investment.

	<i>% of Value</i>		<i>Rate</i>	<i>Product</i>
First Trust Deed	50%	X	6%	3.0%
Second Trust Deed	25%	X	8%	2.0%
Equity Investor	25%	X	10%	<u>2.5%</u>
				7.5%

Gross Multiplier: Often investors use a factor of the gross income to place a property in a price range. For example:

<i>Selling Price</i>		<i>Annual Gross Income</i>	=	<i>Gross Multiplier</i>
\$100,000	÷	\$10,000	=	10
\$90,000	÷	\$10,000	=	9
\$80,000	÷	\$10,000	=	8

Note: This method is never used by a qualified appraiser. Only real estate agents and investors apply this method as a fast “first look” judgment.

For rental income properties, other than single family residential and residential duplexes, appraisers usually make use of annual income figures to determine the proper annual gross rent multiplier (GRM). “8 times the gross income” or “8 x’s gross” is how the multiplier is

expressed. When a portion of a subject property's income is derived from non rental sources, a **gross income multiplier** (GIM) is often used. It would be employed in the same manner as the gross rent multiplier (GRM).

The gross rent multiplier method of analyzing income does not relate to true net income and is more often used as a guideline or "rule of thumb" in identifying possible value.

Cash Flow - Spendable Income

The appraiser is concerned with developing reasonable estimates of gross income, effective gross income, expenses, and net income. He/she does not include in the appraisal process mortgage payments of principal and interest, sometimes referred to as "debt servicing costs." However, debt service is used by an investor to determine the spendable income generated by a property with a given amount of financing. For example:

Gross Income	\$60,000	
Less 10% vacancy factor	<u>\$ 6,000</u>	
Effective gross income		\$54,000
Less all expenses		<u>\$11,700</u>
True net income		\$42,300
Less debt service		<u>\$15,000</u>
Spendable income (cash flow)		\$27,300

Residual Techniques

There are certain standard techniques by which income can be capitalized to determine the value of the property (land and buildings). Land income can be capitalized separately to determine land value and building income can be capitalized separately to discover the value of the building.

Property Residual Income

For this method, the depreciation allowed on the improvements is calculated separately and is then deducted from the estimated net income before depreciation to determine the net income for the entire property (**true net income**). The residual income amount (left over) is attributable to the property (land and buildings) and is then capitalized into the value of the property.

If the net income of a property before depreciation was \$25,300 annually, the building being valued separately at \$180,000, the capitalization rate was 8% and the recapture rate was 2.5% annually, we would proceed as follows:

Net income from property before depreciation	\$25,300
Depreciation (recapture) of building \$180,000 x.025 (2.5%)	<u>- \$4,500</u>
Net Income to the property (land and building)	\$20,800

$$\$20,800 \text{ (property income)} \div .08 \text{ (8\%)} = \$260,000 = \text{Value of property}$$

Land Residual Income

In this method, the building is valued separately. The net income is derived by determining the economic rent or the amount of income which the space would bring in the open market at

the time of an appraisal. Contract rent is the rent that has been bargained for. **Economic rent** is rent determined by comparison to other similar properties and assumes that the property is being employed to its highest and best use. The fair annual net return on the building value (includes capitalization or return rate and recapture or depreciation rate) is deducted from the net income of the entire property before depreciation allowances. The residual amount (left over) is said to be earned by the land alone and is capitalized into a value for the land.

Development method: This method is applied by an appraiser in his/her evaluation of land under development in which he/she projects the land as fully developed in its highest and best use and determines the value of the site by deducting the costs of development. The appraisal manual defines the anticipated use or development method of valuing a site in exactly this way.

Thus, if the net income of a property before depreciation was \$25,300 annually, the building being valued separately at \$180,000, the capitalization rate was 8% and the recapture rate was 21/2% annually, we would proceed as follows:

Net income from property before depreciation	\$25,300
Return & recapture of building \$180,000 x .105 (8% + 2.5%)	<u>- \$18,900</u>
Net Income attributable to land	\$6,400

\$6,400 divided by .08 (8% capitalization rate) = \$80,000 = Value of Land

Building Residual Income

For this method, the land is valued separately and the fair annual net return on the land value is deducted from the estimated net income before depreciation derived from the whole property. The residual amount is attributable to the building earnings and recapture and is capitalized by the combined rates to indicate the building value.

If the net income of a property before depreciation was \$25,300 annually, the land being valued separately at \$80,000, the capitalization rate was 8% and the capture rate was 2.5% annually, we would calculate as follows:

Net income from property before depreciation income attributable to land \$80,000 x .08 (8%) net income to building before depreciation

\$18,900 ÷ .105 (8% +2.5 %) \$180,000 = Value of Building.

One final point is that there are three methods and their variations in appraising a property. It is never acceptable appraisal practice to use all three and then determine the value by using the average. You must use only one main method. The other two are to be used only as a check of accuracy.

Appraisal Practice

After studying the technical aspects of real estate appraisal, both its terminology and its procedures, you should know that throughout the United States a great deal of honest concern and inquiry has been focused on this specialized segment of the real estate industry. The most widely accepted appraiser has either one or both professional designations, M.A.I.

(Member American Institute) or SREA (Society of Real Estate Appraisers) founded in the 1930's. Membership in any other organization is not necessary to receive these designations.

Legislative Concern

Many in government and elsewhere in the business of real estate lending have voiced the opinion that some effort should be made to regulate or license real estate appraisers in some way. Because of the rash of lending institution failures, an accusing finger has been pointed at real estate appraisal practitioners as the real cause for much of the financial difficulty lenders have suffered. The implication is that the appraisal work completed to determine value was questionable, to say the least. Today, an appraiser must comply with stringent laws as well as qualify by taking pre licensing courses, become licensed, and have apprentice experience. No one can appraise for a fee for a lending institution, appraise as an independent fee appraiser, nor can anyone have their work accepted by any court or governmental agency without meeting these requirements

In 1986, the California legislature initiated efforts to do something to improve performance in the field of real estate appraisal. Effective January 1, 1988, the California Civil Code establishes the meaning of the terms **certified appraisal** and **certified appraisal report**.

This law also establishes what procedures should be employed by anyone who offers to make certified appraisals.

As with real estate professionals, disclosure is of paramount importance in the appraisal profession. If the appraiser has any interest in the property or is a relative of the person requesting the appraisal, a disclosure of these facts must be made to everyone that is affected by the appraised value. No kickbacks or undisclosed referrals are permitted. As with the profession of real estate, all discriminatory practices are prohibited.

Certified Appraisal

A **certified appraisal** is an act or process for or in expectation of compensation to produce an analysis, opinion or conclusion relating to the value of specified interests in identified real property. When the act, or process, or the communication of its results, is termed a certified appraisal or any other term which can be confused with a certified appraisal including, registered appraisal or licensed appraisal it is a violation. This is true especially if it is knowingly performed or prepared in response to a requirement or provision in law for the performance or furnishing of a certified appraisal.

The term certified appraisal does not include an appraisal or opinion of value, or any analysis, opinion, or conclusion which is not identified as, and truly is a "certified appraisal."

The Certified Appraisal Report

The law goes on to say that the term "certified appraisal report" means any written communication of an analysis, opinion, or conclusion relating to the value of property which is termed as a certified appraisal report or is in any way described as a communication of the results of a certified appraisal.

The term also states that a certified appraisal report is:

- An oral communication of an analysis, opinion, or conclusion relating to the value of real property which is orally identified as a certified appraisal report.
- A written confirmation which writing is identified as a certified appraisal report.
- Is given by the appraiser within five (5) business days following the oral statement or at the close of escrow, where applicable, whichever occurs later, but never later than the close of escrow.

Compensation for such services is described as any kind of remuneration for performing the act or process of a certified appraisal or preparing or rendering or communicating a certified appraisal report and not for the performance of any activities that would be related to such activity.

Legal Requirements

Anyone who performs a certified appraisal of real property must complete certain prescribed steps and procedures and must employ appropriate terminology as defined in this law.

A certified appraisal report must be presented in clear and unequivocal terms with sufficient information to enable the user of that report, or any other person who may be expected to rely on the report, to understand it properly, and in such a manner as to avoid being misleading. There are no fixed fees applied to a certified appraisal.

No person can accept an assignment to make a certified appraisal or to prepare a certified appraisal report in which the employment itself or the fee or compensation for the service would be dependent on a predetermined or specified value. Nor can a person accept a fee for such services which is contingent upon the amount of any monetary damages arising out of a condemnation or other legal action in which the value of the property to be appraised is disputed.

Any person performing a certified appraisal must retain originals or true copies for three years from the date of submitting the certified appraisal report to the client.

Finally, you should know that any persons who can demonstrate that they will potentially be irreparably damaged by an improperly completed certified appraisal may bring an action for damages, equitable relief, or both, against those who violate this law. The court may, in addition, award costs and reasonable attorney's fees to the prevailing party as it determines to be appropriate.

Chapter 14 Summary

An **appraisal** or valuation is an estimate or opinion of value for a stated purpose as of a given date. The first step in any appraisal is to determine its purpose.

The principle of **substitution** affirms that the maximum value of a property tends to be set by the cost of acquiring a substitute property of equal utility and desirability. The value of a replaceable property tends to be indicated by the value of an equally desirable substitute property. The value of a property tends to coincide with the value indicated by the actions of informed buyers in the market for comparable properties. The cost of producing, through new construction, an equally desirable substitute property usually sets the upper limit of value.

The south and west sides of business streets are, as a rule, preferred by merchants because the pedestrian traffic seeks the shade side of the street and merchandise displayed in the windows is not damaged by the sun. This is referred to as **orientation**.

The width and depth of a lot often determine the possibilities and the character of use. A **depth table** is often used to estimate relative value of commercial lots which vary from a normal depth.

Deferred maintenance is a form of physical deterioration. When normal maintenance has not been performed and a lump sum expenditure is required to correct deficiencies in paint, screens and landscaping, this lump sum amount is classified as deferred maintenance and is deducted from the building value.

Rehabilitation is necessary maintenance, or accrued maintenance.

Functional Obsolescence is probably the greatest cause in the decline in a property's value is the passage of its physical life. This includes a loss of value brought about by such factors as over capacity, inadequacy and changes in the art that affect the property. It is also defined as the inability of a structure to perform adequately the function for which it is currently employed.

Capitalization is the calculation of the present value of future benefits. Using this method on income property, the present value is established by considering the prospective future annual net income of the property. Capitalization converts this net income stream into an estimate of the present worth of the property. This is done by dividing the annual net income by an appropriate interest rate (**cap rate**). The interest rate referred to as the overall rate includes both the return on investment (net income) and the return of investment (the recapture rate.)

Appraising a single-family dwelling involves a lot and a building. The land can be appraised only by comparison. The dwelling, however, can be appraised by cost and comparison approaches, with the greatest weight on the comparison approach.

All three approaches, **cost, comparison** and **capitalization**, can be used in appraising investment property. The greatest weight, however, is given to capitalization since the prime motive for acquisition is to receive income.

The listed prices tend to set the upper limit of value because sellers usually ask for more than they expect to receive. Selling prices tend to set the market value of similar properties.

99% of comparison properties are residential improved property or vacant land.

When a property is new, or when there is no active market for a property, market data is lacking or it has no monthly income to consider, the appraisal approach most likely to be employed would be the cost approach. The **cost approach** determines the cost to reproduce the improvements, subtracts the depreciation, and adds the value of the land. The cost approach is an estimate of the investment which would be required to duplicate a property in its present condition. The cost approach tends to set the upper limit of value. This approach is almost never used on old structures with functional deficiencies.

A net annual income is derived by deducting the total annual expenses from the annual gross income, after making proper allowances for vacancies and collection losses. Expenses should be realistic and include such items as management, real property taxes, services, utilities, insurance and maintenance. Debt service is never included in this list of expenses, as it has no bearing on operational costs. The appropriate gross income that should be used is the expected future gross income, also known as **scheduled gross income**. The gross scheduled is that income based upon all units being rented all the time. The realities are that there will be some vacancies and rent collection losses over the economic life of the property. Therefore, when you subtract a factor for vacancies and rent losses, the remainder is called **Effective Gross Income**.

Regarding capitalization rates: Given a fixed income amount: **The higher the rate, the lower the value; the lower the rate, the higher the value.**

In the **Land Residual Income** method, the building is valued separately. The net income is derived by determining the economic rent or the amount of income which the space would bring in the open market at the time of an appraisal. Contract rent is the rent that has been bargained for. **Economic rent** is rent determined by comparison to other similar properties and assumes that the property is being employed to its highest and best use. The fair annual net return on the building value (includes capitalization or return rate and recapture or depreciation rate) is deducted from the net income of the entire property before depreciation allowances. The residual amount (left over) is said to be earned by the land alone and is capitalized into a value for the land.

chapter 14 quiz

- 1. The price at which a willing seller would sell and willing buyer would buy, neither being under abnormal pressure is known as:**
 - a. Assessed value.
 - b. Insurance value.
 - c. Market value.
 - d. Investment value.
- 2. An elevation drawing (plan) discloses:**
 - a. Lot dimensions and lot improvements drawn to scale.
 - b. Exterior sides of a building after all work has been completed.
 - c. Essential detail concerning size of footings, size and dimensions of piers, and subfloor areas.
 - d. Wall to wall measurements, room sizes and exposures, and placement of doors, windows, fireplace, cabinets and garage.
- 3. To an appraiser, value means:**
 - a. A desirous thing and a person desiring it.
 - b. A commodity that will bring money or another commodity.
 - c. The present use of future benefits arising out of ownership.
 - d. Any of the above
- 4. Peter is considering the purchase of a commercial property that will involve significant remodeling and will result in the building being inappropriate for any other purpose. Peter will consider the factor of:**
 - a. Value in exchange.
 - b. Diminishing returns.
 - c. Reproduction value.
 - d. Book value.
- 5. An increase in utility of land through the annexation of contiguous lots by the same owner is called:**
 - a. Joint purchase.
 - b. Plottage.
 - c. Demurrage.
 - d. Combined value sale.
- 6. A four bedroom, one bath home is now an example of:**
 - a. Economic obsolescence.
 - b. Physical deterioration.
 - c. Social obsolescence.
 - d. Functional obsolescence
- 7. A person builds a \$250,000 home in a neighborhood of \$75,000 to \$85,000 homes. Shortly thereafter he/she is able to sell it only at a price less than \$250,000. The loss may be attributed to:**
 - a. Functional obsolescence.
 - b. Physical depreciation.
 - c. Economic obsolescence
 - d. Bad luck
- 8. In the appraisal of real property the impairment of desirability in the use of the property is sometimes attributed to economic changes identified as:**
 - a. Over improvements.
 - b. Deed restrictions.
 - c. Economic life.
 - d. Obsolescence.
- 9. The final step in the appraisal process is to correlate the results of the three approaches to value and arrive at a single estimate of value. This correlation is accomplished by:**
 - a. Adding the three value estimates and dividing by three.
 - b. After reviewing each of the approaches, the appraiser should weigh the relative significance of each. He/she should then place the most significance on the approach which, in his/her judgment, is most applicable.
 - c. Both A and B are correct.
 - d. Neither A nor B are correct.
- 10. When using the comparative method to determine value using comparable properties, an appraiser would make an adjustment for:**
 - a. Properties in different neighborhoods
 - b. Properties of different square footages.
 - c. A selling price over six months old.
 - d. All the above.



“Before you start trying to work out which direction the property market is headed, you should be aware that there are markets within markets.”

— Paul Clitheroe

CHAPTER 15: *real estate marketing trends*

Learning Objectives

The real estate industry is primarily one in which agents search for new people to work with as it relates to the clients' needs to find places to buy, sell, finance, or lease. Sometimes, finding a qualified and truly motivated client is almost the equivalent of finding a needle in a giant haystack. To increase the chances of success, the agent must learn the latest household and other demographic trends. Understanding the most effective ways to reach this target audience by way of various types of online and print media marketing methods will be covered within this chapter.

key terms

Baby Boomers

Circle of Influence

Generation X

Generation Y / Millennials

Generation Z

Greatest Generation

Internet Penetration

No-Fault Divorce

Social Media

Sphere of Influence

Real Estate is a People Business

The real estate profession is more of a people business than a property business. Agents and brokers must develop a level of trust and rapport between themselves and their prospects. Agents must be likable in order to convert that new prospect to a loyal client for one, or hopefully, several transactions over years.

Changing household formation and other demographic trends play an important role in determining whether there is sufficient buyer or seller demand for properties. As of 2015, there are now more Latinos who live in California than buyers deemed “non-Hispanic whites” or Caucasian. So, real estate agents who are fluent in English and Spanish are likelier to pick up more market share in their communities. Additionally, agents who speak one or more Asian or European languages may find some incredibly wealthy residential and commercial real estate buyers if agents know how to locate them.

Many agents are not only a fiduciary, like a financial advisor or attorney, but also act as a spiritual advisor or therapist when helping the clients through the complex and stressful process of buying or selling a home because trust is at the core of this business relationship. When there are financial struggles and/or marriage difficulties during the transaction, the stress levels can skyrocket for both the principals and the agents involved.

Many times, an impending divorce, a new marriage, or a new baby on the way, may be the primary factors why clients are motivated to sell and/or buy new properties. During times of divorce in home sales, agents must be cautious to not share the family secrets with new client prospects. If confidential information is shared with a buyer prospect or agent, they may offer a lower price, damaging the sellers even more. This can be a serious ethics violation for licensees.

Because there are millions of marriages and divorces each year across the United States, agents should learn about the opportunities and risks associated with these family dynamics. In divorce situations, there might be opportunities to sell the main home while helping one or both soon-to-be ex-spouses find a new place to purchase or lease. Conversely, a newly engaged couple may be quite eager to find a new home to purchase after they get married or if they are about to have a baby together.

How Marriage and Divorce Trends Impact Household Formations

California was the very first state in America to offer **No-Fault** divorce in which one spouse doesn't have to prove that the other spouse did something wrong. This No-Fault divorce was passed in 1969 by former California Governor and U.S. President Ronald Reagan. As a result, it became easier to file for a quick divorce in California. This had a definitive impact on household formation structures over the next several decades.

The U.S. Census Department reported that there were 12,807,387 households in California between 2012 and 2016. Within each household, the average number of occupants was 2.95 persons per household. In recent years, it has become much more common for single occupants to live in small homes, condominiums, apartments, guest cottages, or individual bedrooms within another person's home. California offers more high-density or small housing units (i.e., 300 square foot apartment units with no bedrooms) to single occupants than any other state partly as a result.

Listed below are some of the published data numbers from sources such as the U.S. Census Department, the National Center for Health Statistics (NCHS), Pew Research, and other data sources regarding household formation trends that directly affect the real estate field:

- National divorce rate average in the US: up to 53%.
- California's average divorce rate is close to 60%.
- 41% of first marriages end in divorce.
- 60% of second marriages end in divorce.
- 73% of third marriages end in divorce.
- The average U.S. marriage that ends in divorce lasts just 8 years.
- The U.S. has the highest percentage of one-person households in the world.
- There is one U.S. divorce every 36 seconds on average; 2,400 divorces per day; 16,800 divorces per week; and 800,000 to 900,000 divorces each year.

Global Household Formation Trends

Because so many real estate buyers in California are foreign investors or new California residents who were born outside of the U.S., and more people are currently getting married at older ages, let's review the numbers in regard to some of the larger metropolitan cities and nations around the world to learn about their share of marital and divorce data trends as a comparison to American household numbers:

1. **Doha, Qatar:** Average marriage length - 5.5 Years; 38% national divorce rate.
2. **Cape Town, South Africa:** Average marriage length - 11 years; 31.2% national divorce rate.
3. **Tokyo, Japan:** Average marriage length - 11 years; 36% national divorce rate.
4. **Mexico City, Mexico:** Average marriage length - 12 years; 15% national divorce rate.
5. **Sydney, Australia:** Average marriage length - 12 years; 43% national divorce rate.
6. **New York City, U.S.:** Average marriage length - 12.2 years; 50% national divorce rate.
7. **Paris, France:** Average marriage length - 13 years; 55% national divorce rate.
8. **Ottawa, Canada:** Average marriage length - 13.8 years; 48% national divorce rate.
9. **Rome, Italy:** Average marriage length - 18 years; 30.7% national divorce rate.

Average Age at Marriage Across the World for Populous Nations

Rank	Country	Average Age at Marriage
1.	Germany	33.1
2.	Brazil	30.8
3.	Japan	30.5
4.	United States	27.9
5.	United Kingdom	27.9
6.	Thailand	26.7
7.	Turkey	26.2
8.	Russia	25.7
9.	Philippines	25.6
10.	China	25.3

Sources: *Business Week*, *Priceonomics*, and *The United Nations*

Divorce by Ages and Gender:

Age	Women	Men
Under 20 years	27.6%	11.7%
20 to 24 years	36.6%	38.8%
25 to 29 years	16.4%	22.3%
30 to 34 years	8.5%	11.6%
35 to 39 years	5.1%	6.5%

Highest Divorce Rates Worldwide

1. Belgium - 71%
2. Portugal - 68%
3. Hungary - 67%
4. Czech Republic - 66%
5. Spain - 61%
6. Luxembourg - 60%
7. Estonia - 58%
8. Cuba - 56%
9. France - 55%
10. USA - 53%

Declining Marriage Numbers in the 21st Century (2000 - 2016)

Year	New Marriages	U.S. Population	Rate per 1,000 Population
2000	2,315,000	281,421,906	8.2
2001	2,326,000	284,968,955	8.2
2002	2,290,000	287,625,193	8.0
2003	2,245,000	290,107,933	7.7
2004	2,279,000	292,805,298	7.8
2005	2,249,000	295,516,599	7.6
2006	2,193,000	294,077,247	7.5
2007	2,197,000	301,231,207	7.5
2008	2,157,000	304,093,966	7.5
2009	2,080,000	306,771,529	6.8
2010	2,096,000	308,745,538	6.8
2011	2,118,000	311,591,917	6.8
2012	2,131,000	313,914,040	6.8
2013	2,081,301	306,136,672	6.8
2014	2,140,272	308,759,713	6.9
2015	2,221,579	321,418,820	6.9
2016	2,245,404	323,127,513	6.9

Sources: CDC, Statistics Canada, The Economist, Australian Institute of Family Studies, Family and Court Disorder, and Pew Research

Shortening Attention Spans & Advertising Styles

The Microsoft company conducted two separate studies in the years 2000 and 2015 that closely studied a few thousand participants regarding their brain activity functions related to their attention span. In the 2000 study for Microsoft, the published results noted that the average attention span for their American and Canadian test subjects was about 12 seconds. In the subsequent 2015 test study, the results showed that the average attention span has fallen dramatically to just 8 seconds. The 8 second results were listed as just one second worse than a goldfish's attention span.

Shortening attention spans are also causing shorter relationship time spans and smaller household formations. Because so many people these days are somewhat fearful or hesitant to get married or even enter a longer term romantic relationship, it is becoming more common for friends to live with one another. It is not unusual to see strangers unite to rent rooms, guest houses, cottages, or apartment units for shorter periods of time. This can be positive for agents specializing in short-term rentals.

With so many younger generational group members who grew up with high tech gadgets for most of their lives and online search engines that can answer questions within one second, they are likely to want quick answers and almost 24-hour access to their real estate or financial advisors, 365 days per year, for better or worse. Some agents may enjoy being on-call for their clients 24-7, because they are thankful for the business opportunities. Other agents may become overwhelmed by 3am texts and phone calls when they are trying to sleep.

Many studies today make the claim that most Americans get their news sources from online digital content as opposed to printed newspapers or magazines. There are many free or very affordable price options for online forms of advertising for real estate agents that include blogs, websites, and social media ads. Also, business pages on platforms such as Facebook, LinkedIn, Instagram, YouTube, and Twitter offer advertising. Print media can be rather costly, running in the thousands of dollars, for agents interesting in publishing newspaper or magazine ads. Sometimes, these print media ads can be quite effective, generating high rates of return that are 10 or more times higher than the advertising expense if the agent successfully closes a transaction directly originated from a prospect who saw the ad.

For new agents who may have little to no available funds to pay for print or online media advertising, they may consider learning about how to create free online ad links or blogs that can attract new prospects. As transactions begin to close escrow and the commissions start flowing in on a regular basis, the agent will have more flexibility to choose future forms of advertising.

Agents should think of advertising costs as a form of an investment rather than an expense. Why? The \$100 or \$1,000 spent on advertising may later generate a \$10,000, \$20,000, or \$30,000 plus net commission to the agent. If so, then the true rates of return for these advertising investments might vary from 10 to 1 (or a \$10,000 commission off a \$1,000 advertising cost) to 300 to 1 (a \$30,000 commission from a \$100 advertising cost) rates of return.

The advertising options selected are more likely to be successful for agents if these same ads can quickly grab their readers' attention whether it be online or in the print media. This is especially true today as people's attention spans get shorter and shorter. For some online ads, they must grab the reader's attention in a second or two before the reader scrolls to another site. Repetition is the key to subliminal programming and advertising success, so it is critically important for agents to repeatedly run their ads so that prospects see it over and over. Many contacts are made only after 10 or more ads are viewed before the prospect finally contacts the agent about their services or properties listed for sale or lease.

Know Your Target Market

An agent's advertising strategies selected are only as good as their target markets. For example, a real estate agent with a brand new \$5 million beachfront listing in Newport Beach may have more success advertising in the local MLS rather than in a small newspaper in a small town hundreds of miles away with a median home price closer to \$200,000. Agents should also consider the preferred advertising styles for their preferred target audiences. If the agent

has a brand new one-bedroom condominium unit for sale that would be an exceptional first property for a recent college graduate, then the same agent may wish to consider advertising in various types of online sites that attract younger business professionals.

Digital Media's Exponential Growth Rates

As of early 2018, over half of the world's population is now online either with a smartphone, a desktop computer, a tablet, or some other type of digital or technological device. In 2017, an estimated 250 million new global users came online for the very first time. A high percentage of this new growth online originated from better and more affordable access to smartphones and mobile data plans. An estimated 200 million people worldwide received their very first smartphone in 2017. As of 2018, approximately 66% of the world's 7.6 billion residents now own a mobile phone or smartphone.

Active Users of Global Social Media Platforms (as 1/2018)

Platform	Number of Global Users
#1 - Facebook	2.167 billion
#2 - YouTube	1.500 billion
#3 - WhatsApp	1.300 billion
#4 - FB Messenger	1.300 billion
#5 - WeChat	980 million
#6 - QQ	843 million
#7 - Instagram	800 million
#8 - Tumblr	794 million
#9 - Qzone	568 million
#10 - Sina Weibo	376 million

Source: We Are Social and Hootsuite

Please note that *WeChat*, *QQ*, *Qzone*, and *Sina Weibo* are all based in China. As such, four of the top 10 most visited social media platform sites are Chinese. Because so many Chinese and other Asian investors like to invest in real estate specifically in the state of California, more California agents and brokers should learn as much as possible about these powerful and well-connected social media platforms that could open the doorway to potentially millions of new prospects based in the Asia.

California agents in the 21st century need to realize that their target audience today is just not the surrounding neighborhood community around their work and/or home office. Rather, it is a global market that can be tapped by way of the digital world. Few places in the world are more appealing to domestic and foreign investors than prime property in California. For example, a few studies found that upwards of 50% to 80% of all new home buyers in the city of

Irvine, California were Chinese in 2015, 2016, and 2017. The more options available to California real estate licensees, the more likely that they will find consistent business opportunities that can keep them quite busy for years to come.

Internet Penetration by Global Region

As of January 2018, the internet penetration numbers as compared with the nation's or region's total population reached 53% worldwide, per a study conducted by *We Are Social* and *Hootsuite*. Let's take a closer look at the lowest to highest internet penetration usage numbers as compared with the region's overall total population numbers:

Global Region	Internet Penetration Percentages
Middle Africa	12%
Eastern Africa	27%
Southern Asia	36%
Western Africa	39%
The Caribbean	48%
Northern Africa	49%
Central Asia	50%
Southern Africa	51%
Eastern Asia	57%
Southeast Asia	58%
Central America	61%
Western Asia	65%
South America	68%
Oceania	69%
Eastern Europe	74%
Southern Europe	77%
North America	88%
Western Europe	90%
Northern Europe	94%

Source: We Are Social and Hootsuite

Top 10 Internet Penetration Numbers by Nation (January 2018)

Country	Internet Users	Total Population
1. Qatar	99%	2,640,360
2. United Arab Emirates	99%	9,376,171
3. Kuwait	98%	4,100,000
4. Bermuda	98%	60,125
5. Bahrain	98%	1,499,193
6. Iceland	98%	329,675
7. Norway	98%	5,222,786
8. Andorra	98%	75,366
9. Luxembourg	98%	572,216
10. Denmark	97%	5,571,635

By comparison, the U.S. has close to an 88% internet penetration rate as compared to the overall population numbers.

Generational Demographics

Let's review the main generational groups that directly impact real estate and the overall economy:

The Greatest Generation (born prior to 1928) and the Silent Generation (1928-1945): Many of these Americans bravely fought in World War II or in other regional and global conflicts when they were drafted or voluntarily joined the military. A large percentage of these Americans lived through the brutal economic years of the Great Depression (1929 - 1939) when stock and home values plummeted to significant lows, bank runs became quite common as thousands of U.S. banks went out of business, and national unemployment levels reached 25%.

Because this generation experienced such wide economic swings from boom to bust markets, they were more conservative with their money. For example, the members of this generational group might purchase one or more properties and never sell it again. They would just transfer the asset to future generations, such as their children or grandchildren. Many of their home purchases were in the \$1,000 to \$20,000 price ranges that later escalated in price to \$500,000 to \$1 million dollars or more, especially if the homes were coastal properties in California. If so, some of these generation members had millions of dollars' worth of assets that they could transfer to their younger family members.

Baby Boomers (born between 1946 and 1964): The baby boom generational group name was coined because of the increasing number of babies born after the end of World War II. In the first year of the baby boom birth wave in 1946, there were approximately 2.4 million babies born. By the last year of the baby boom wave in 1964, there were nearly 72.5 million baby boomers in the United States. This generational group peaked in size in 1999 when the collective numbers reached 72.5 million baby boomers.

This group was fortunate to ride the inflation wave with asset purchases (e.g., real estate and stocks) that doubled, tripled, or even increased 10-fold or more in value over the 1950s, 1960s, 1970s, 1980s, 1990s, and the first two decades of the 21st century. It was quite common to see baby boomers buy a home in California for \$20,000 that later was worth \$1 or \$2 million. As a result, they are considered to own and control the most wealth of any generational group. This real estate and stock wealth would later be transferred to their children in future years.

Generation X (born between 1965 and 1980): Generation X has also been referred to as the “baby bust” generational group because the annual birth rates per household fell below the much higher baby boom group. Even though an estimated 75% of Generation X members earned more than baby boomers did when they were the same age, due to factors such as inflation and higher overall wages, only about 36% of Generation X members had as much wealth as their parents, per a report conducted by Pew Charitable Trusts. This is partly due to the weaker purchasing power of the dollar and much higher student loan debt.

As a generational group, Generation X members had the highest amount of student loan debt, which both helped them find higher paying jobs because of the increased education and hurt them with the rapidly increasing school costs. By 2020, there were an estimated 65.6 million Generation X members, depending upon various demographic reports.

Generation Y/Millennials (born between 1981 and 1996): By 2015, millennials had surpassed baby boomers as the largest generational group of Americans. Pew Research Center defines anyone born between 1981 and 1997 as a millennial (also known as Generation Y). In 2015, millennials would have been within 18 to 35 years old. The combined number of millennials counted in this age range was 75.4 million Americans. Millennials exceeded the number of baby boomers (born between 1946 and 1964) by almost 500,000 people because there were an estimated 68.7 million baby boomers in 2020.

From 2015 thereafter for the next few years, millennials were also ranked as the #1 overall home buying group, the #1 generational group for tenants or renters, and the #1 overall generational group in the U.S. workforce.

Generation Z (born between 1995 and 2010): Per a 2018 study published by Barclays, the generational group known as Generation Z (born between 1995 and 2009 or 2010) is now the largest generational group in America and across the world. The social media data collection company Socialnomics also claimed that more than 50% of the world’s entire population is now under the age of 30 (a mixture of Generation Z and Generation Y/Millennials).

The Barclays report found that the younger Generation Z group already has close to \$200 billion dollars’ worth of purchasing power and up to \$1 trillion dollars’ worth of indirect purchasing power available to them. In addition, the Generation Z group has future access to trillions and trillions of dollars’ worth of inheritance funds from their Generation X and baby boomer parents who created significant amounts of wealth while holding their appreciating assets related to investments, including real estate and stocks, for several decades.

By 2020, Generation Z is the largest group of consumers around the world. Per the global strategy consulting firm Booz & Company, the Generation Z group may account for 40% of consumer business worldwide in the United States, Europe, and in the top four BRIC nations (Brazil, Russia, India, and China).

As such, these younger generational buyers will be a dominant group of future buyers, sellers, tenants, and landlords for real estate agents. This especially applies in California since real estate values are so much higher and there has been more family wealth created due to decades of compounded real estate growth in the state.

Communicating with Millennials and Generation Z

Both Millennials (Generation Y) and Generation Z generational members grew up in the information rich digital world. Many of these people were literally using high-tech gadgets as early as 1, 2, or 3 years of age. For a high percentage of these 100 million plus Generation Y (Millennials) and Z members, they have spent the bulk of their lives communicating with friends, family, and strangers online rather than in face-to-face conversations in person.

Many of these people prefer texting, emailing, or chatting online via Facebook Messenger or some other social media platform device that gives them a relatively high degree of anonymity. If a person has spent the past 20 or 30+ years primarily communicating with others using online technology systems that don't involve voice on a telephone, they are probably not very likely to suddenly change their preferred communication methods to speak with their real estate agent who calls them on a daily basis. Many times, the younger person will not even pick up their phones to talk, even if they can see the caller I.D. notification that lets them know who is on the other end of the call.

Sphere of Influence

The larger the agent's potential referral network and the more effective targeted marketing methods selected, the greater the odds for a long and successful real estate career. After the agent selects their target audience and the best marketing methods to reach that group of prospects, the agent should consider expanding their **sphere of influence** (or "circle of influence"). This sphere of influence includes friends, family, co-workers (past and present), classmates (elementary school, high school, and college), church groups, and other club groups. Agents can share their latest listings with these prospects by way of postcards, flyers, and emails with links back to the agent's website or blogs. Each prospect within the agent's sphere of influence or contact circle may also refer their own friends and family as this circle grows on an exponential basis.

To be an effective salesperson, agents must understand the true root needs and interests of their clients. Sometimes, the needs are to find a larger home for an expanding family or household. Other times, a client needs to downsize after a family or roommates split apart.

Once the clients' needs and interests are discovered, agents must learn their clients' preferred communication styles such as text, phone, email, or some other contact strategy. Just as a person speaking English can't communicate well with a person who only understands Japanese,

two people should find a common communication strategy that they both understand so that they are able to work together and easily reach one another. This way, they are likely to build a successful agent and client team that will hopefully lead to many closed transactions together.

Chapter 15 Summary

As of 2015, there are now more Latinos who live in California than non-Hispanic whites or Caucasian residents. As a result, there can be language barriers to overcome for agents who only speak one language.

Agents act like a **fiduciary** in business relationships built upon trust, confidence, and things of value with their clients just like a banker or attorney.

California was the very first U.S. state to offer **No-Fault** divorce back in 1969. Easier divorce options with no valid reasons have significantly changed how households were created across the state.

As of 2016, the U.S. Census Department reported that the average California household had 2.95 persons per household.

America leads the world in single household formations. This is partly why there are so many new “high-density” or very small housing units being offered to the public, some as small as 300 square feet in size.

The national divorce average is as high as 53% while the divorce average for California is closer to 60%.

Per a 2015 Microsoft study, the average attention span for an American or Canadian was reported as just 8 seconds based upon the scanning of brain waves and other testing methods. This is one second worse than a goldfish.

Over 50% of the world’s population was online as of 2018. There were 250 million new online users as of 2017 alone.

Facebook (2.167 billion users) and YouTube (1.5 billion users) were the top two most visited online platforms in the world as of 2018.

Four of the Top 10 most visited online platforms were based in China: *WeChat*, *QQ*, *Qzone*, and *Sina Weibo*.

North America had a reported 88% internet penetration rate (or number of online users as a percentage of overall population) while Northern Europe was ranked #1 in the world with a 94% internet penetration rate. Since there are many California real estate buyers from Europe, South America, Asia, and other parts of the world, California licensees should research the best ways to market their property listings or services to foreign investors.

Both Qatar and United Arab Emirates in the Middle East had a 99% internet penetration rate. Investors from this wealthy region are some of the biggest buyers of commercial real estate in California and other states.

Millennials have been the #1 largest generational group for the purchase and leasing of properties for several years starting in 2015. They are also the largest working group today in America.

Baby boomers (born between 1946 and 1964) are the wealthiest generational group after decades of real estate and stock ownership plus compounded inflation growth.

Generation X (born between 1965 and 1980): Generation X has also been referred to as the “baby bust” generational group because the annual birth rates per household fell below the much higher baby boom group. Even though an estimated 75% of Generation X members earned more than baby boomers did when they were the same age, due to factors such as inflation and higher overall wages, only about 36% of Generation X members had as much wealth as their parents

Generation Z (born between 1995 and 2010) are now the largest generational group. It is estimated that more than 50% of the world’s population is now under the age of 30. By 2020, this group is expected to be the largest consumer group in the world.

Agents should work towards expanding their **sphere of influence** or “circle of influence” by tapping into their network of friends, family, and old business, school, and social contacts for increasing business opportunities.

chapter 15 quiz

1. Latinos become the largest race in California in:

- a. 2010
- b. 2012
- c. 2015
- d. 2017

2. California offered No-Fault Divorce options starting in:

- a. 1958
- b. 1963
- c. 1965
- d. 1969

3. Per the 2012 - 2016 U.S. Census, the average California household size was:

- a. 3.75
- b. 2.95
- c. 2.29
- d. 1.65

4. The average divorce rate in California is approximately:

- a. 60%
- b. 54%
- c. 46%
- d. 33%

5. Per a 2015 Microsoft study, the average attention span for Americans and Canadians was:

- a. 12 seconds
- b. 10 seconds
- c. 8 seconds
- d. 4 seconds

6. A \$10,000 net commission earned off a \$1,000 advertising cost or investment is equal to a:

- a. 10 to 1 return
- b. 100 to 1 return
- c. 100% return
- d. 200% return

7. The social media platform with the most annual users worldwide is:

- a. YouTube
- b. Facebook
- c. QQ
- d. Sina Weibo

8. Which region of the world had the highest internet penetration percentage rate?

- a. North America
- b. Western Asia
- c. Middle East
- d. Northern Europe

9. Between 2015 and 2018, the generational members who purchased the most residential properties nationwide were:

- a. Generation X
- b. Millennials
- c. Baby Boomers
- d. Generation Z

10. As of 2018, the generational group with the largest number of members was:

- a. Generation X
- b. Generation Y
- c. Generation Z
- d. Baby Boomers

Afterword

Good Luck?

“Successful real estate salespeople do not achieve their success through luck. They create their success by forming the habits of success that have worked for others and will work again for everyone with the desire to find their greatness in my profession. In my humble opinion, real estate is the last outpost of *free enterprise*. To those of us who have already achieved our personal greatness, helping others to achieve their real estate goals is a great service. As Aristotle said 2,500 years ago, ‘True success is only found in expressing yourself in service to others.’ We exist and work in a profession where we can live by this admonition. We can find our personal success in real estate, the greatest profession on the face of God’s green earth. I will close by simply wishing you: Success combined with happiness. You now know the way. It is now up to you.”

John Lumbleau

1928-2010

100-QUESTION
practice test

- 1. Because the real estate housing market is varied in nature and deals with many different types of desires and needs, it is said to be:**
 - a. Structured.
 - b. Stratified.
 - c. Fractured.
 - d. Fractionated.
- 2. The desk cost for a broker is:**
 - a. The cost of equipment divided by the number of desks in the office.
 - b. The cost of equipment plus rent divided by the number of desks.
 - c. The cost of equipment, phones and rent divided by the number of desks.
 - d. The cost of equipment, phones, rent and administrative salaries divided by the number of desks in the office.
- 3. Commingling is most nearly the opposite of:**
 - a. Trust fund.
 - b. Mingle.
 - c. Segregate.
 - d. Neutral depository.
- 4. Which of the following best describes conversion?**
 - a. The broker deposits a cash deposit into his personal account after an offer is accepted and instructed to by the seller.
 - b. The broker receives a check from a buyer and deposits it in his personal account and commingles it with his own money.
 - c. The broker receives a check from a buyer with instructions from the buyer to hold the check until the offer is accepted.
 - d. The agent receives a \$500 cash deposit and spends it on a vacation in Nevada.
- 5. A broker may accept which of the following from a buyer for a deposit?**
 - a. Postdated check.
 - b. Unsecured promissory note.
 - c. Promissory note secured by a deed of trust.
 - d. All of the above.
- 6. Should a dispute regarding a commission arise between two REALTOR® licensees, the Code of Ethics recommends settlement by:**
 - a. Litigation.
 - b. Estoppel.
 - c. Arbitration.
 - d. Mandamus.
- 7. The document used to transfer title to a mobile home is:**
 - a. A vehicle certificate of registration
 - b. A bill of sale.
 - c. A deed.
 - d. A compliance agreement.
- 8. As a California real estate broker, an out-of-state broker refers a client to consummate a sale. Under California real estate law:**
 - a. You may pay a commission to a broker of another state.
 - b. You cannot divide a commission with a broker of another state.
 - c. You can pay a commission to a broker of another state only if he is also licensed in California.
 - d. None of the above.
- 9. Copies of all listings, purchase agreements, canceled checks, and trust records must be retained by a licensed real estate broker for:**
 - a. One year.
 - b. Two years.
 - c. Three years.
 - d. Five years.

- 10. Arthur Davidson, a licensed real estate broker, falsely advertises that he is a REALTOR®. Which of the following best describes this situation?**
- There is nothing wrong with this.
 - It is a felony. A district attorney may prosecute him.
 - He is subject to discipline by the Real Estate Commission for using the word REALTOR®.
 - A listing obtained because of the advertisement would be void.
- 11. A real estate licensee who misrepresents a property to a buyer while acting as agent for a seller may subject himself to:**
- Disciplinary action by the licensing authority.
 - Civil action.
 - Criminal action.
 - All of the above.
- 12. If the broker is the agent of the seller, he owes the buyer:**
- The duty of honesty and fair dealing.
 - The same fiduciary obligation he owes to the seller.
 - Only the duty to answer questions honestly.
 - Only a duty to disclose any item which relates directly to the sales price of the property.
- 13. The law of agency concerns itself with the right, duties, and liabilities between and among:**
- Agent and a third party with whom the agent deals.
 - Principal and agent.
 - Principal and third party introduced by the agent.
 - All of the above.
- 14. The position of trust assumed by the broker as an agent for a principal is described most accurately as:**
- A gratuitous relationship.
 - A trustor relationship.
 - A fiduciary relationship.
 - An employment relationship.
- 15. John Smith is the agent of the buyer. He should disclose this relationship to other persons involved in a sales transaction:**
- After he secures the listing.
 - Before escrow is opened.
 - Immediately after escrow has closed.
 - As soon as possible.
- 16. Which of the following is not an act of misrepresentation?**
- Puffing.
 - Negligent fraud.
 - Conversion.
 - Mistake.
- 17. The word “rescind” means:**
- Changed.
 - Terminated.
 - Substituted.
 - Subordinated.
- 18. The best way to establish an agency relationship is by:**
- An oral agreement.
 - Voluntary by agent.
 - Implied contract by law.
 - Written contract.

- 19. An agent that does not receive a commission but is still responsible to be a fiduciary to his or her client is known as a:**
- Subagent.
 - Gratuitous agent.
 - Ostensible agent.
 - Special agent.
- 20. Failure to disclose a material fact to a buyer or seller can be best described as:**
- A nuisance.
 - A misdemeanor.
 - A violation of real estate law.
 - Fraud that subjects a licensee to disciplinary action, civil action and possibly criminal action.
- 21. Legally, property is:**
- Real that is tangible.
 - Personal – fixtures.
 - Personal if not real.
 - All of the above.
- 22. The principal difference between real property and personal property is:**
- Value.
 - Permanence.
 - Length of life.
 - Mobility.
- 23. Stock in a mutual water company:**
- Requires a separate written contract to convey to the buyer.
 - Is appurtenant to land and thus automatically transfers to the buyer.
 - Must be mentioned in the deed to transfer it to the buyer.
 - Must be owned as tenants in common.
- 24. A grant deed passes title when it is:**
- Executed.
 - Delivered.
 - Recorded.
 - Acknowledged.
- 25. The following word is most nearly the opposite of alienation:**
- Acceleration.
 - Amortization.
 - Acquisition.
 - Avulsion.
- 26. The primary purpose of a deed is to:**
- Move title.
 - Encumber a property.
 - Secure a lien on a property.
 - Grant a person the use of a property, but not to have title to it.
- 27. Fee simple estate most closely refers to:**
- The greatest interest a person can own in land.
 - An easy way to transfer title to land.
 - An expensive way to transfer title to land.
 - A common way to hold title to land.
- 28. The following would possess an “estate” in real property:**
- A beneficiary.
 - A mortgagee.
 - A life tenant.
 - All of these.

- 29. All of the following are classified as real property, except:**
- a. Mineral, oil and gas rights.
 - b. A leasehold on a residence.
 - c. Uncultivated fruit trees.
 - d. An easement appurtenant.
- 30. The term demise means to:**
- a. Alienate.
 - b. The intestate.
 - c. Appoint an executor.
 - d. Appoint an administrator.
- 31. Which of the following is not required to create a lease for more than one year?**
- a. It must be in writing.
 - b. Lessor and lessee must both always sign it.
 - c. A termination date.
 - d. The amount of rent and the method of payment.
- 32. One of the features of owning real property as tenants in common is:**
- a. Each co-owner must have equal interest.
 - b. Each owner may not will his interest.
 - c. Each co-owner may acquire interest at different times in different instruments.
 - d. The sole survivor owns the property in severalty.
- 33. The unities of possession, title, time and interest are necessary in order to create the following types of ownership:**
- a. Tenancy in common.
 - b. Joint tenancy.
 - c. Community property.
 - d. Severalty.
- 34. The unities of time, title, interest, and possession relate to:**
- a. Devisees of heirs acquiring status as tenants in common.
 - b. The theory of survivorship.
 - c. The presumption of a tenancy in partnership.
 - d. An estate at will.
- 35. A corporation cannot hold title to real property as a:**
- a. Joint tenant.
 - b. Tenant in common.
 - c. Partnership.
 - d. Limited liability company.
- 36. When real property is held by husband and wife as community property, an agreement to sell that property which has been signed by only one spouse would be:**
- a. Illegal.
 - b. Unenforceable.
 - c. Binding.
 - d. A violation of the Statute of Frauds.
- 37. Once the proprietor of a business has filed a fictitious business name statement in the office of the county clerk, it will expire:**
- a. Never, unless abandoned.
 - b. 10 years from July 1 in the fiscal year in which it is filed.
 - c. 5 years from December 31 in the year in which it is filed.
 - d. 10 years from the date it is filed.
- 38. Warehousing, an important activity in the field of financing, applies to:**
- a. Mortgage portfolios.
 - b. Title insurance.
 - c. Corporate trustee.
 - d. Servicing of defaulted loans.

39. A trust deed differs from a mortgage in which of the following respects:

- a. Possession.
- b. Recording.
- c. Trustee.
- d. Amortization.

40. The type of mortgage loan that permits borrowing additional funds later is called a/an:

- a. Equitable mortgage
- b. Junior mortgage
- c. Open end mortgage
- d. Extendible mortgage.

41. The document used to release a loan secured by a trust deed is the:

- a. Deed of reconveyance.
- b. Certificate of discharge.
- c. Certificate of sale.
- d. Mortgagee's statement.

42. A mortgagee who finds it necessary to foreclose a mortgage would:

- a. Notify the trustee of the default.
- b. File an attachment.
- c. Notify the mortgagor of the default, wait 90 days and then publish a notice of default in a newspaper of general circulation.
- d. File an action in court.

43. The person most apt to use a "bench mark" in the practice of his profession would be:

- a. Lawyer.
- b. Carpenter.
- c. General contractor.
- d. Surveyor.

44. In California the minimum crawl space in a structure, as required by the building codes, is:

- a. 16 inches.
- b. 18 inches.
- c. 20 inches.
- d. 24 inches.

45. When an air conditioning unit has a higher energy efficiency ratio (EER), it means that:

- a. The unit is less efficient.
- b. The unit is more efficient.
- c. It needs more wafts of electricity.
- d. The BTU's are larger.

46. One of a series of parallel beams to which the boards of a floor and/or ceiling laths are nailed would be a:

- a. Joist.
- b. Rafter.
- c. Stud.
- d. Brace.

47. A kiosk is a:

- a. Type of residential roof.
- b. Parallel beam to which boards of a floor or ceiling laths are nailed.
- c. Freestanding booth in a parking lot or shopping mall.
- d. Metal pipe in which electrical wiring is installed.

48. The higher the R rating is:

- a. The greater the efficiency of the hot water heater.
- b. The greater the resistance to the passage of heat (better heating insulator).
- c. The lesser the efficiency of a furnace.
- d. None of the above.

49. Soil pipe is used in:

- a. Irrigation.
- b. Sewer system.
- c. Agriculture.
- d. Horticulture.

50. Each row of townships running north and south parallel to a true meridian is called a:

- a. Township.
- b. Section.
- c. Range.
- d. Tier.

51. California has how many principal base and meridian lines?

- a. Only one.
- b. Two.
- c. Three.
- d. Five.

52. In the planning and engineering of a tract for subdivision purposes, a “cul de sac” is frequently employed. This term is used in reference to the installation of:

- a. Sewage disposal.
- b. Drainage.
- c. Streets.
- d. Recreation areas.

53. When a public agency takes private property for public use, it is an exercise of:

- a. Police power.
- b. Eminent domain.
- c. Neither A nor B.
- d. Both A and B.

54. The police power of government would include all of the following, except:

- a. Condemnation.
- b. Zoning.
- c. Building regulations.
- d. Subdivision controls.

55. State law requires that every city or county create a Planning Commission:

- a. When funds have been appropriated by the local governing body.
- b. Without exception.
- c. After a master plan has been approved.
- d. Membership of which must be comprised of at least three members of the City Council or County Board of Supervisors.

56. California requires that every city and county must adopt a comprehensive long term general plan (master plan) to guide the future development of:

- a. Proposed major thoroughfares and transportation routes.
- b. The general distribution and location and the extent of the uses of land for residential, commercial and industrial purposes.
- c. The identification and appraisal of potential seismic hazards.
- d. All of the above.

57. Zoning changes may be initiated by:

- a. Subdividers.
- b. Local authorities.
- c. Individuals.
- d. All of the above.

58. The following is an example of police power:

- a. The taking of real property in order to widen a freeway.
- b. Deed restrictions.
- c. Zoning.
- d. Income taxes.

- 59. The basic regulation and control of the housing and construction industries in California is accomplished through:**
- Local building codes.
 - State Housing Law.
 - State Contractors License Law.
 - All of the above.
- 60. A landlord cannot require the following from a prospective tenant:**
- Good credit and solid income.
 - References.
 - That unmarried (single) tenants have a co-signer.
 - Security deposit.
- 61. The following type of syndicate requires at least 100 participants:**
- Corporation.
 - Real estate investment trust.
 - Limited partnership.
 - Joint venture.
- 62. Should there be a violation of the provisions of the Civil Rights Act of 1968, Title VIII Fair Housing, the aggrieved person may seek relief by:**
- Filing a civil action in state court.
 - Filing a civil action in a federal district court.
 - Filing a complaint with the secretary of Housing and Urban Development.
 - Any of the above.
- 63. The Equal Credit Opportunity Act that was enacted in 1974 was created to:**
- Set uniform interest rates on real estate loans in the country.
 - Set minimum requirements to enable a person to make credit purchases.
 - Prohibit discrimination based on the sex and marital status of the credit applicant in the extension of credit.
 - Set uniform standards for the documents used in extending credit.
- 64. In California the following official enforces anti discrimination laws and seeks to assure housing accommodations for anyone no matter their race, color or creed:**
- The Real Estate Commissioner.
 - The Director of Housing and Community Development.
 - The Labor Commissioner.
 - The Fair Employment and Housing Commission.
- 65. Which of the following best defines a contract?**
- Two or more persons entering into a legal agreement.
 - Two or more competent persons entering into a legal agreement to do a legal act.
 - Two or more competent persons entering into a legal agreement for a consideration to do or not to do a certain thing.
 - Two or more competent persons entering into an agreement to do or not to do a certain thing.
- 66. All the following are necessary elements of a contract except:**
- Must have a legal object.
 - Competency of the parties.
 - Payment of money.
 - Meeting of the minds.
- 67. A contract is signed by a party who, through fraud of the other party, is deceived as to the nature of the contents of the document itself. Contract is:**
- Valid.
 - Voidable.
 - Void.
 - None of the above.

68. A contract signed under duress is:

- a. Valid.
- b. Void.
- c. Voidable.
- d. Unenforceable.

69. As used in real estate practice, a rider:

- a. Is an amendment.
- b. Is a person.
- c. Is a lien.
- d. Is a contract.

70. A clause in a trust deed providing that the rights of the beneficiary are secondary to those of holders of subsequently recorded trust deeds is known as:

- a. Acceleration.
- b. Alienation.
- c. Subrogation.
- d. Subordination.

71. The word “subordinate” is most opposite in meaning to the word:

- a. Superior.
- b. Inferior.
- c. Subrogation.
- d. Deference.

72. The contractual agreement for the purchase of real property which is ordinarily used when a buyer does not have a large down payment is called:

- a. A security agreement.
- b. A land contract.
- c. A deed of trust.
- d. An option agreement.

73. All of the following statements concerning the “Land Contract” method of financing the purchase of real property are true, except:

- a. Death of the seller might force litigation to obtain title.
- b. Lending institutions consider land contracts to be poor collateral.
- c. There is a possibility that the buyer would not get clear title.
- d. The buyer is assured of obtaining title to the property upon completion of the terms of the contract.

74. A banking year is:

- a. 360 days.
- b. 364 days.
- c. 365 days.
- d. None of the above.

75. The following statement is true with the respect to options. An option is:

- a. Valid without consideration.
- b. Valid if the consideration is exactly \$10.00 but is not delivered.
- c. Valid if consideration is delivered even if it is less than \$10.00.
- d. Not valid if the delivered consideration is less than \$10.00.

76. If escrow instructions, signed by both parties, contain terms in conflict with the original purchase agreement, the following is true:

- a. Escrow instructions will control.
- b. The original contract will prevail.
- c. A new contract must be drawn up between buyer and seller.
- d. Buyer could demand that his deposit be refunded.

77. During escrow, if an unresolved dispute should arise between the seller and buyer preventing the close of escrow, the escrow holder may legally:

- a. Arbitrate the dispute as a neutral party.
- b. Rescind the escrow and return all documents and monies to the respective parties.
- c. File an interpleader action in court.
- d. Do any of the above.

78. The escrow agent usually is the agent of:

- a. Buyer.
- b. Seller.
- c. Buyer and seller.
- d. Buyer, seller and third parties.

79. Should an owner taxpayer sell residential property at a loss, he could report the loss on his/her federal income tax return:

- a. If it was used as a business property but only if there was a profit realized in the year of sale.
- b. If it is used as rental income property.
- c. If it is used as the taxpayer's residence.
- d. If the taxpayer had capitalized the property taxes.

80. Depreciation has which of the following effects?

- a. Increases value.
- b. Decreases cost basis.
- c. Creates a lien.
- d. None of the above.

81. When an owner adds a swimming pool to an apartment property, it has the following effect on his income taxes:

- a. He may deduct the cost of the pool as an expense.
- b. He will get a credit to offset a portion of the rental income.
- c. He will increase his basis in the property.
- d. It will have no effect on his taxes.

82. When filing his federal income tax return, the owner of a condominium in which he resides may take a deduction for his portion of:

- a. The interest payments for the mortgage on the common areas.
- b. The maintenance expenses for the common areas.
- c. The repairs to his individual unit.
- d. All of the above may be deducted.

83. Harley enters into an agreement to exchange investment real estate he owns with a fair market value of \$330,000 and an adjusted basis of \$220,000. He is exchanging this property for an investment property with a fair market value of \$360,000. Both properties were owned free and clear and no boot is given or received by either party. Hadley's basis on his new property would be:

- a. \$110,000
- b. \$140,000
- c. \$220,000
- d. \$330,000

84. Which of the following is an expense or cost to a homeowner?

- a. Interest lost on equity investment in the home.
- b. Reduction in the value to the lot.
- c. Appreciation due to painting.
- d. Increase in amenities.

85. Ad valorem most nearly means:

- a. The price at which a property could be expected to sell when it has been on the market for a reasonable period.
- b. Income taxes.
- c. According to value.
- d. None of the above.

86. Equity is best defined as the:

- a. Means of clearing a cloud on title.
- b. Purchase price of a property less the loans on it.
- c. Fair market value of a property less the loans on it.
- d. All of the above.

- 87. The basic protection of a lender on a purchase money second trust deed would be:**
- Equity of the borrower.
 - Credit rating of the borrower.
 - Amount of a second trust deed.
 - The borrower's ability to repay.
- 88. What is the nominal rate of interest you would pay on a conventional loan:**
- Interest with discount points so it will be more than the simple interest rate.
 - The maximum amount of interest allowed by law.
 - The legal rate of interest.
 - The amount of interest agreed upon in the contract.
- 89. A note on which only interest is paid during its term is called:**
- A straight note.
 - An amortized note.
 - An installment note.
 - Void.
- 90. A principal lender for financing the purchase of residential property is:**
- Savings banks.
 - Commercial banks.
 - Insurance companies.
 - Federal National Mortgage Association.
- 91. Mr. Davidson is building an eight-unit apartment and is financing the construction through a local mortgage company. The terms of financing provide that funds are to be released to him at various stages of construction. Under the terms, the moneys released would be referred as:**
- Sight drafts.
 - Obligatory advances.
 - Acceleration payments.
 - Mechanics' Liens.
- 92. The lowest rate of interest given by banks to their best customers is called:**
- Discount rate.
 - Prime rate.
 - Equity rate.
 - Conventional rate.
- 93. If a person borrows money to purchase a personal residence, the loan most likely would be insured by:**
- VA
 - FHA or private mortgage insurer.
 - Federal National Mortgage Association, Federal Home Loan Mortgage Corporation and Government National Mortgage Association.
 - The lender.
- 94. The purchaser of a residence was informed that the amortization period of his loan has recently lengthened. The method of financing used was most likely:**
- Veterans Administration.
 - California Veterans Farm and Home Purchase Act.
 - Conventional.
 - Federal Housing Administration.
- 95. To an appraiser, value means:**
- A desirous thing and a person desiring it.
 - A commodity that will bring money or another commodity.
 - The present use of future benefits arising out of ownership.
 - Any of the above
- 96. When using the comparative method to determine value using comparable properties, an appraiser would make an adjustment for:**
- Properties in different neighborhoods
 - Properties of different square footages.
 - A selling price over six months old.
 - All the above.

97. Per a 2015 Microsoft study, the average attention span for Americans and Canadians was:

- a. 12 seconds
- b. 10 seconds
- c. 8 seconds
- d. 4 seconds

98. The social media platform with the most annual users worldwide is:

- a. YouTube
- b. Facebook
- c. QQ
- d. Sina Weibo

99. Between 2015 and 2018, the generational members who purchased the most residential properties nationwide were:

- a. Generation X
- b. Millennials
- c. Baby Boomers
- d. Generation Z

100. Per the 2012 - 2016 U.S. Census, the average California household size was:

- a. 3.75
- b. 2.95
- c. 2.29
- d. 1.65



“Libraries will get you through
times of no money better than
money will get you through
times of no libraries.”

Anne Herbert

Glossary

1031 Tax-Deferred Exchange: Section 1031 of the United States Revenue Code that allows the capital gains of certain types of properties to be deferred.

A.I.C.D.C.: Attention, Interest, Conviction, Desire, and Close. Also, known as the “5 Points of Salesmanship” or the “5 Stages of Action” from the Dale Carnegie Professional Sales Course.

Ability-to-Repay: A rule included by the CFPB under the Qualified Mortgage guidelines that attempts to make the seller, lender, real estate agents, and mortgage brokers personally liable if a borrower defaults due to improper qualifications.

Abstract of Title: A summary or digest of the conveyances, transfers, and any other facts relied on as evidence of title, together with any other elements of record that may impair the title.

Accelerated Cost Recovery System: The system for figuring depreciation (cost recovery) for depreciable real property acquired and placed into service after January 1,1981 (ACRS). Since January 1987, because of some changes, this system is officially known as the modified accelerated cost recovery system (MACRS).

Accelerated Depreciation: A method of cost write off, for income tax purposes, in which depreciation allowances are greater in the first few years of ownership than in subsequent

Acceleration Clause: A part of a real estate financing instrument which allows the lender to foreclose should the borrower be late on their payments, or if the borrower sells the property to a new buyer who does not formally qualify to take over payments.

Acceptance: A legal term referring to the acceptance of an offer. A buyer offers to buy and the seller accepts the offer.

Accession: Material improvement or addition to an existing piece of property.

Accession: Title acquired through annexation or accretion.

Accounts Payable: A running record of business transactions showing the amounts of money owed. They are considered liabilities.

Accounts Receivable: Amounts of money remaining unpaid to the seller of stock in trade in the ordinary course of business. They are considered as assets.

Accredited Management Organization (AMO): A professional designation of the Institute of Real Estate Management (IREM).

Accredited Residential Manager (ARM): A professional designation of the Institute of Real Estate Management (IREM).

Accretion: Acquisition of title from natural causes. Land forms by imperceptible degrees upon the bank of a river or stream caused by the action of the water in washing up sand, earth, and other materials on the shore. Such added land becomes the property of the owner of the waterfront property.

Accrued Depreciation: The actual loss of value existing in a property at a given date. Depreciation that has already occurred.

Acknowledgment: A formal declaration made before an authorized person such as a licensed Notary Public who legally confirms that the signer was in fact the true named person.

Acre: A unit of land defined as 43,560 sq. ft. or 1/640 of a square mile.

ACRS (Accelerated Cost Recovery System): The system for figuring depreciation (cost recovery) for depreciable real property acquired and placed into service after January 1,1981 (ACRS). Since January 1987, because of some changes, this system is officially known as the modified accelerated cost recovery system (MACRS). A modification of the Accelerated Cost Recovery System that is the current tax depreciation system in the United States.

Actual Age: The number of actual years since the original completion of the building structure.

Actual Agency : An agency relationship established by the execution of an express agreement between the seller and broker, typically with a listing agreement.

Actual Authority: Specific powers expressly conferred by a principal to an agent to act on the principal's behalf. This power may be broad, general power or it may be limited, special power as in a listing agreement.

Actual Notice: A legal term to indicate in court that the actual information or knowledge of the matter has been conveyed to parties

Ad Valorem: A Latin term meaning "according to value". A way to assess taxes as a percentage of value as currently used for property taxes.

Adaptability: One way to determine real or personal property that includes how an item is physically attached to the property.

Addendum: Additional material added to a contract that requires approval by all parties to the contract to be enforceable.

Adjustable Interest Rate: A rate that fluctuates with the changes in economic conditions. Found in variable interest rate loans and CAL Vet loans.

Adjusted Cost Basis: The cost basis after the application of certain additions for improvements, etc. and deductions for depreciation, etc.

Administrator or Administratrix: A person appointed by the probate court to administer the estate of a person who died leaving a will without naming an executor, or one who died with heirs but left no will.

Advance Fee: A fee collect before services are provided. DRE must approve all advertising materials associated with these fees prior to use.

Adverse Possession: A method of acquiring title to property without a deed. Current law requires strict observance of certain provisions because the title is being transferred as an operation of law without the consent of the holder of the title and without any court action.

Affidavit: A declaration reduced to writing and sworn to or affirmed before some officer who has authority to administer an oath or affirmation. Usually given by a person who is averse to taking an oath.

Affirm: To confirm, to aver, to ratify, to verify.

Affirmation: A solemn declaration made under the penalties of perjury by a person who conscientiously declines taking an oath. This is equivalent to an oath.

Age Life Method: Used in estimating depreciation of a structure (also called the straight-line method).

Agency: A relationship between an agent and principal. Best in writing but also obtainable through ostensible means, ratification of actions, or through the actions of the agent. One who represents another from whom he/she has derived authority. Because the agency can be created solely through the action of an agent, consideration is not essential to its creation.

Agency Disclosure Law: A specific area of Commercial Law which detail the many types of agency relationships.

Agent: One who acts for and with authority from another called the principal.

Agreement of Sale: A written contract between seller and buyer in which they reach a meeting of minds on the terms and conditions of the sale.

Agreement of the Parties: One way to determine real or personal property that includes whether there was a written agreement between the parties as to which fixtures are to remain with the property.

Agreement to Convey: An agreement for the purchase and sale of real property.

AITD: An All-Inclusive Trust Deed is a deed of trust that includes the balance due on one or more existing loans plus new funds that are loaned. Also, known as a wrap-around mortgage.

Alienate: To alienate the title also means to transfer it, as by deed. The opposite of alienation is acquisition.

Alienation: The transfer of property and possession of lands, or other things, from one person to another. Most often used in a trust deed note calling for the entire note to become due if the owner sells (alienates) the property.

Alienation Clause: Part of a mortgage contract that requires full payment of the loan at the lender's discretion if the property is sold or title to the property changes.

Alluvium: Deposits of earth made by the natural action of the water, as through accretion.

Alquist-Priolo Special Studies Act: Regulates development in earthquake fault areas in California. The law requires the State Geologist to establish Earthquake Fault Zones of active faults and to issue appropriate maps.

ALTA: The American Land Title Association policy covers additional risks than the CLTA policy such as unrecorded mechanic's liens, assessments, encumbrances, encroachments, easements, water rights, and boundary disputes.

Ambulatory: Subject to being altered; changeable. A will is said to be ambulatory; the testator may change it prior to death.

Amenities: Added value to residential income property as well as to single family dwellings. Proximity to markets, transportation, amusement and shopping centers, churches, etc., are factors of value. Certain locations will appeal to potential tenants and the rents will be higher in these than in similar buildings in different locations. Upgrades over the neighborhood standard are also considered amenities, such as a tile kitchen when other homes have Formica tops.

Amortization: The liquidation of a financial obligation on an installment basis; also, recovery, over a period, of cost or value.

Anchor Bolt: A bolt that securely binds the sill to the foundation wall.

Anchor Tenant: The key tenant in a shopping mall. Typically, a major department store or retail chain store used to draw in consumers for the benefit of smaller retail stores.

Annexation: Acquisition of title by a tenant attaching personal property to the land of another without an agreement permitting the tenant to remove it.

Annuity: A sum of money received at fixed intervals, such as a series of assured equal or nearly equal payments to be made over a period, or it may be a lump sum payment to be made at some time in the future. The installment payments due to a landlord under the terms of a lease are an example of an annuity. The installment payments due to a lender on a note are another such example.

Apparent Authority: A type of agency relationship associated more with observing the principal or agent's actions or behaviors.

Appraisal: The act or process of developing an opinion of value.

Appraisal Institute: A merger of the Society of Residential Appraiser with the American Institute of Real Estate in 1990.

Appreciation: An increase in value.

Appropriation of Water: The taking, impounding or diversion of water flowing on the public domain from its natural course and the application of the water to its beneficial use personal and exclusive to the appropriator (taker).

Approved Appraiser: An appraiser hired by the lender instead of the borrower, mortgage broker, or loan officer.

Appurtenance: Something belonging to the land and transferred with it, such as buildings, fixtures, rights, mutual water stock, easements etc.

Arm's Length Transaction: A sales transaction in which neither the buyer or seller are acting under duress or threats; both parties have sufficient knowledge of the estimated market value while also very likely to be working with agents and other third party real estate specialists.

As Is: A term referring to an owner's desire to sell a property without warranting anything. The Law, by court decision, states that an "as is" sale does not allow the owner to escape the disclosures, on a seller's disclosure statement, of all the items mandated by law to allow the buyer the opportunity to know what he/she or she is buying and the opportunity to rescind the offer to buy.

Asbestos: A naturally occurring mineral that has long fibrous crystals that is resistant to fire, heat, and chemical damage. Often mixed with cement or woven into fabric, it is now known that prolonged inhalation of asbestos fibers can cause serious and fatal illnesses.

Assemblage: Putting together two or more lots to form a large parcel (see Plottage).

Assessed Value: A value placed upon property by the tax assessor.

Assessment: The valuation of property in order to levy a tax, or the amount of the tax levied.

Assessor: The governmental official responsibility for determining and assessing property values within a specific city or county region such as a Tax Assessor's Office.

Assignability: Usually referring to a contract. Example - A land contract is assignable. A listing, because it is a personal service contract, is non-assignable.

Assignment : A transfer, or turning over to another, the whole of any property, real, personal, or of any estate or right therein. Assign to transfer or turn over to another. The one who owns the property being assigned is called the assignor; the one who receives the property being assigned is the assignee.

Assumption (Assume): The qualification, transfer, or assignment of an existing mortgage loan balance to another borrower after the formal approval by a lender.

ATEC: Appreciation - Tax Savings - Equity - Cash Flow. Four elements to evaluate before making an informed investment decision.

Attachment: Seizure of property by court order, usually done to have it available in the event a judgment is obtained in a pending suit.

Attorney-In-Fact: One who is authorized to perform certain acts for another under a Power of Attorney; may be limited to a specific act or acts, or be general.

Authority: The legal power or right to give orders or make decisions.

Avulsion: The sudden tearing away removal of land by action of water flowing over or through it.

B.T.U: British thermal unit. A standard used for measuring heating and air conditioning capacity.

Baby Boomers: People born after World War II approximately between 1946 and 1964.

Back-end DTI: A loan qualification formula used by most lenders that calculates the debt-to-income ratio (DTI) that includes PITI plus any additional payment obligations such as car payments, student loans, and credit card payments.

Backfill: Dirt and other matter that is filled in around retaining walls, foundations, or other excavations.

Back-up Offer: An offer held in back-up position if multiple offers are received by the seller.

Bailment: A contract where personal property is delivered by one party to another, held for a purpose, and later returned. A pawnbroker.

Bailor: One who delivers goods or money to another in trust.

Balance Sheet: A financial statement made to show the true condition of a business as of a certain time. Discloses assets, liabilities and net worth.

Balloon Mortgage: A requirement in loan terms that a large principal payment is repaid in a single payment at the end of the loan period.

Balloon Payment: Where the final installment payment on a note is greater than the preceding installment payments and it pays the note in full, such final installment is termed a balloon payment. Used mostly in second trust deed or junior loans. Often referred to as a partially amortized loan versus a fully amortized loan which is normally used in first trust deed financing.

Band of Investment Theory: The Band of Investment method is a combination of mortgage and equity rates which market data discloses as existing on comparable properties. The rate developed is a weighted average, the weighting consisting of the percentages of value of the mortgages and the equity of the owner.

Banking Year: Twelve months of 30 days totaling 360 days.

Bankruptcy: A general term for a federal court procedure that helps consumers and businesses get rid of their debts and repay their creditors.

Base and Meridian: Imaginary lines used by surveyors to find and describe the location of private or public lands. California has three principle base and meridian lines from which all surveys begin. They are, in Northern California the Humboldt Base Line and Meridian, in Central California the Mount Diablo Base Line and Meridian, and in Southern California the San Bernardino Base Line and Meridian

Base Lines: The imaginary lines used in land survey descriptions that run east to west and intersect with meridians that go north and south.

Base Molding: Molding used at top of baseboard.

Base Shoe: Molding used at junction of base board and floor. Commonly called a carpet strip.

Baseboard: A board placed against the wall around a room next to the floor.

Batten: Narrow strips of wood or metal used to cover joints, internally or externally; also, used for decorative effect.

Beam: A structural member transversely supporting a load.

Bearing Wall: A bearing wall is a wall that supports weight of the structure. It is intact during remodeling; you do not remove it. A bearing wall can be at any angle to a door that one wishes, i.e., certain entry halls. Normally, your bearing wall is required to be of stronger construction than would be a partition that does not bear weight.

Bench Mark: A fixed marker from which differences in elevation are measured by surveyors.

Beneficiary: The lender on the security of a note and deed of trust on a specific lien on a specific piece of property. The person or company who receives the monthly payments or, if not paid, has the trustee sell the specific property and receives the receipts from the sale.

Beneficiary's Statement: A written form from a lender itemizing the exact balance of a loan as of a given date, together with accrued interest, interest rate, and other items of the loan needed for payoff.

Bequeath: To give or leave personal property by a will.

Bequest: The transfer of personal property, or other types of assets, by will.

Bill of Sale: Document used to transfer the title of personal property and manufactured/mobilehomes.

Blacktop: Asphalt paving used in streets and driveways.

Blanket Encumbrance: A single mortgage or trust deed which covers more than one piece of real estate.

Blanket Mortgage (Trust Deed): A loan which covers more than one property with or without partial reconveyance built into the loan so that portions of the encumbered properties can be later sold off or refinanced individually.

Blighted Area: A declining area in which real property values are seriously affected by destructive economic or natural forces.

Blind Ad: A form of advertising a property for sale or lease where the person fails to identify as a licensed agent by not including their agency designation or license number.

Blockbusting: A method of inducing or attempting to induce any person to sell or to rent any dwelling on the grounds of a potential loss of value, due to the present or anticipated entry into the neighborhood of persons of another race, color, religion, ancestry or national origin.

Board Foot: A measure of lumber one foot square by one inch thick. (12" x 12" x 1" = 144 cu. in.)

Board of Equalization: Administers California's sales, use, fuel, alcohol, tobacco, etc. tax and collects fees that fund specific state programs.

Bonafide: In good faith, without fraud or deceit; authentic; sincere.

Book Value: The amount of an asset as carried on the records of an owner and not necessarily the amount that it could bring in the open market. Book value is computed by the cost of the asset plus additions and improvements, minus accrued depreciation.

Boom Time: An economic era when interest rates are low, access to financing is easy, and there is an abundance of inventory.

Boot: A term to describe something of value received in an exchange of real estate. Typically used when discussing tax implications of a 1031 Exchange.

Bracing: Framing lumber nailed at an angle to provide rigidity.

Breach: The failure to perform a function or action as imposed by law or included within a contract.

Breakdown Method: Used in estimating depreciation. A refinement of the engineering method. In this method, not only are construction components recognized, but also the components of depreciation, physical deterioration, functional obsolescence and economic obsolescence are treated separately.

Bridging: Small wood or metal pieces used to brace floor joists.

B.T.U.: British thermal unit. A standard used for measuring heating and air conditioning capacity.

Building Line: A line set by law or deed restriction. A certain distance from the street line in front of which an owner cannot build on his/her lot. (Also called a setback line).

Building Paper: (Tar Paper) A heavy waterproofed paper used as sheathing in wall or roof construction as a protection against air and moisture.

Built-In: Cabinets or similar features built as part of the house.

Bundle of Rights: The legal rights linked to property ownership such as the right to possess and occupy, sell or transfer, and encumber with mortgage debt.

Business: a commercial or industrial enterprise.

Business Opportunity: The various assets including within the ownership or sale of an existing business, including the “goodwill” or positive business reputation in the community.

Buyer’s Agent: A real estate salesperson working exclusively for their buyer.

Buyer’s Market: A period in the economy when real estate prices are decreasing. A favorable position for the buyer to negotiate a lower price on a property. Usually, during this time there are excess listings available and during the lowest period there are foreclosed properties available at a lower price. During the cycle when the market changes from a buyer’s market to a seller’s market prices of homes will first stabilize then increase.

C.A.R.: California Association of REALTORS®. A trade association composed of members of local real estate boards of REALTORS® in California. Any real estate licensee in this state, broker or salesperson, may become a member of this professional association by becoming a member of any real estate board in the state.

C.P.M.: Certified Property Manager; a member of the Institute of Real Estate Management (IREM) of the National Association of Realtors.

C.R.V.: Certificate of Reasonable Value. An appraisal given under the Veterans Administration that sets the limit of the loan to be given by setting the appraised value of the property.

C1/C2/C3/CR: Codes for different types of property zoning. C1 may refer to commercial zoning and CR may refer to a combination of commercial and residential zoning. Each Planning and Zoning Department may use different codes.

CA Dept. of Corporations: The governing body of California escrow companies.

CA Dept. of Insurance: The governing body of California title insurance companies.

CA Senate Bill 1159: Effective January 1, 2016 removing the legal presence requirement from the application process to obtain a real estate license.

CalBRE: California Department of Real Estate, now known as the Department of Real Estate (DRE).

California Fair Employment and Housing Act (FEHA): A California law that prohibits a wide number of housing discrimination practices conducted by landlords, real estate agents, and unlicensed property managers. FEHA defines discrimination as one’s refusal to sell or lease properties based on race, color, gender, religious beliefs, familial status such as single, married, or divorces, and disability status.

CalVet: A California veteran that may be eligible for special financing terms when purchasing a home in California.

Cap Rate: The capitalization rate is the ratio of Net Operating Income (NOI) to property asset value. A \$1,000,000 property that generates an NOI of \$100,000 would have a cap rate of 10% ($\$100,000/\$1,000,000$).

Capacity: To have the mental ability to enter into a contract.

Capital Gain: The true or net taxable gains from the sale of a property after deducting the original cost basis plus any improvements, if applicable.

Capitalization: A method of determining the value of property by converting the property's net income into a percentage which represents a reasonable return on invested capital.

Capitalization Rate: The rate of interest which is considered a reasonable return on the investment. It is used in the process of determining value based upon the flow of net income of a real property investment.

CAR: California Association of REALTORS® formed in 1905.

Carbon Monoxide: A colorless, odorless, and tasteless gas that is toxic to animals and humans when encountered in concentrations above about 35 ppm.

Casement Window: Window frames of wood or metal which swing outward.

Cash Flow: The positive or negative income stream that an investor receives each week, month or year.

Casing: A frame as of a window or door.

Caveat Emptor: "Let the buyer beware." The buyer must examine the goods or property and buy at his/her own risk.

CC&Rs: A declaration of covenants, conditions and restrictions that rule a homeowner's association (HOA) or a HOA community.

Ceiling Height: According to latest FHA requirements, minimum ceiling height in a single family residential construction is 7'6" (90 inches) or 7 1/2 feet.

Certificate of Discharge: A statement executed by the lender showing that the loan has been paid. Also known as a Release of Mortgage.

Certificate of Reasonable Value: A type of formal appraisal certification for VA loans.

Certified Apartment Manager (CAM): A designation of the NAA considered to be one of the top management licensing designation nationwide for individuals that primarily work with multifamily apartment rentals.

Certified Appraisal: An act or process for or in expectation of compensation to produce an analysis, opinion or conclusion relating to the value of specified interests in identified real property by a licensed appraiser.

Certified Property Manager (CPM): A designation of IREM to certify individual property managers to ensure candidates meet the required high standards associated with property management, business management and accounting.

CFD: Community Facilities Districts. Part of Mello-Roos legislation to raise money for district schools, roads, libraries, parks, police, fire, etc. through additional property tax assessments.

CFPB: The Consumer Financial Protection Bureau created by the Dodd-Frank Act in 2010.

Chain of Title: The history of ownership and subsequent conveyances or sales for a property over the life of the property's existence.

Chattel Mortgage: A mortgage on personal property.

Chattels: Goods of every species of property movable or immovable which are not real property. Personal property

Chattels Real: An interest in real estate less than freehold such as estates for years, at will, and by sufferance. A lease of real estate for a term of years constituting an estate less than a freehold estate is called a chattel real which passes a present interest in real property.

Chattels: Any type of property that is not considered to be real property.

Chose in Action: A personal right not reduced to possession, but recoverable by an action at law.

Circle of Influence: A salesperson's group of friends and family. Typically, the first source of clients for a new salesperson. Also known as Sphere of Influence.

Circuit Breaker: An electrical device which automatically interrupts an electric circuit when an overload occurs; may be used instead of a fuse to protect each circuit and can be reset.

Civil Code: A section of California Law in which the statutes dealing with agency relationships are found.

Civil Rights Act of 1968: Also known as the Fair Housing Act, it prohibited discrimination concerning the sale, rental and financing of housing based on race, religion, national origin and sex.

Clapboard: Boards usually thicker at one edge used for siding.

Closing Costs: The fees required to close an escrow made up of recurring and non-recurring costs.

Closing Date: The date a deed is recorded at the County Recorder's office showing the new owner of record.

Closing Disclosure: Prior to October 3, 2015 called the HUD 1, a statement of charges and credits to the buyer and seller in financing a real estate transaction.

Closing Statement: The final settlement agreement disclosing the final selling price.

Cloud on Title: Any conditions revealed by a title search which affect the title to property; usually relatively unimportant items but which cannot be removed without a quitclaim deed or court action.

CLTA: The California Land Title Association title insurance policy that is also known as the standard coverage title policy.

Code of Ethics: Principles, values, standards, or rules of behavior used to guide REALTORS® in their business dealings with the public, clients and fellow agents

Codes: A systematic collection of laws in writing.

Codicil: A change or amendment to a will.

Cold Calls: An unsolicited call to someone, by phone or in person, to sell goods or services.

Collar Beam: A beam that connects the pairs of opposite roof rafters above the attic floor.

Collateral Security: A separate obligation attached to another contract to guarantee performance of the contract.

Collusion: An illegal agreement between two or more persons to defraud another of his/her rights by the forms of law, or to obtain an object forbidden by law.

Color of Title: That which appears to be good title but which, in fact is not.

Combed Plywood: A grooved building material used primarily for interior finish.

Commercial Acre: A term applied to the remaining portion of a full acre of newly subdivided land after allowances for dedicated public streets, roads, and alleys.

Commercial Bank: A neighborhood bank who seeks depositors and makes smaller loans for shorter terms to well-known borrowers within their immediate community. The lowest interest they charge their most credit worthy borrowers is called the “prime rate”.

Commingling: The mixing of broker’s personal or business funds with one or more client’s deposited funds that were supposed to go into a separate escrow or bank account.

Commission: A payment for the performance of specific duties in real estate; a percentage of the selling price of property, percentage of rentals, etc. Automatically received if anyone, including the owner, sells when the agent is working under an exclusive right to sell listing.

Commitment: The act of promising or pledging to do a certain thing, as a lending institution would commit itself to lend money.

Common Law: The body of law that grew from customs and practices developed and used in England and which forms the basis for real property law in the United States.

Community Apartment Project: A project in which an undivided interest in the land is coupled with the right of exclusive occupancy of any apartment located thereon.

Community Property: Property that legally belongs to two spouses. When survivorship taxes are not of concern to spouses with shared interest in real property, a grant deed for community property may be used to transfer property from one spouse to the other.

Community Redevelopment Act: Evolved into the Community Redevelopment Law Reform Act of 1993 to address abuses and add restrictions to redevelopments in urban areas.

Compaction: Whenever extra soil is added to a lot to fill in low places or to raise the level of the lot, the added soil is often too loose and soft to sustain the weight of buildings. Therefore, it is necessary to compact the added soil so that it will carry the weight of buildings without the danger of their tilting, settling, or cracking. Expensive for a contractor.

Company Dollar: The remainder of the sales commission after the broker has shared with a cooperating broker and the licensed sales agents in his/her office.

Comparative Method: A method for determining cost or cost of reproducing an improvement. Also, used to determine the current cost of renting either office or warehouse space.

Comparative Unit Method: A method for determining cost or cost of reproducing an improvement on a per unit basis.

Compound Interest: The accrued, unpaid interest paid on the original principal amount which grow or snowballs over time (or interest paid on interest plus principal).

Condemnation: The act of taking private property for public use by the sovereign powers; a declaration that a structure is unfit for use.

Conditional Commitment: A lenders agreement to finance a property subject to conditions, i.e. an appraisal or verification of income of work.

Conditional Sales Contract: A contract for the sale of property stating that delivery is to be made to the buyer, title to remain vested in the seller until the conditions of the contract have been fulfilled.

Condominium: A system of individual fee ownership of units in a multi family structure, combined with the joint ownership of common areas of the structure and the land.

Conduit: Usually a metal pipe in which electrical wiring is installed.

Conforming Loan: A mortgage loan that qualifies to be purchased in the secondary markets by Fannie Mae and Freddie Mac.

Conformity: The principle of conformity holds that maximum value is realized when there is a reasonable degree of architectural homogeneity and where land uses are compatible.

Consideration: Refers to an object or service of value that is bargained for and received by a promisor from a promisee; also, money or something else of value, given in exchange for something of said equal value.

Constructive Notice: Notice given by public records.

Consumer Credit Reporting Agencies Act: California regulatory agency for businesses that report on consumer credit to insure fair treatment and privacy for the public.

Consumer Financial Protection Bureau: See CFPB.

Consumer Recovery Account: Funded by fees paid by licensees to financially support victims who have been defrauded by real estate licensees.

Contemporary Architecture: of functional design, modern, as distinguished from the traditional or stylistic.

Contiguous: To touch upon, border upon, in physical contact, touching near or adjoining. A term used to describe the relative position of parcels of land.

Contingencies: A provision whereby one or more parties can be released from an obligation under a contract in the event that some stated condition fails to materialize.

Contingent Commission: Income based or conditioned on future payments being made by a buyer on a real property sales contract.

Continuing Education (CE): All salesperson and broker license renewals require completion anytime during the four-year period preceding the renewal of a DRE approved 45 hours of continuing education courses.

Contract: An agreement, written or oral, to do or not to do certain things.

Contract of Sale: A written agreement for the exchange of goods, services or real estate for an agreed upon amount.

Contract Rent: Payment for the use of property designated in a lease. This term is used to establish the fact that the actual rent paid (contract rent) may differ from economic rent (market rental value).

Contribution: This principle may be said to be the principle of increasing and decreasing returns as it applies to some portion of improvement. This principle would be applied in the feasibility study of a proposed modernization or remodeling project. Contribution can positively or negatively impact the value of a property. A new swimming pool may impact value more than its cost. Asbestos, found in a building constructed prior to 1953 would have a major negative effect on value.

Conventional Financing: See Conventional Loan.

Conventional Loan: A loan that is underwritten or approved using governmental underwriting guidelines, and a loan typically sold off in the secondary markets to governmental agencies.

Conversion: The use of client or customers' funds for the company or personal needs.

Conveyance: An instrument in writing used to transfer (convey) title to property from one person to another, such as a deed.

Co-op: Short for cooperative. An association of owners united to jointly own a building or business.

Cooperating Agent: An agent who assists another agent with his/her listed property for sale.

Cooperating Broker: An agent or the agent's brokerage who assists another agent with his/her listed property for sale.

Corporation: A creature of law, or "legal person," having certain powers and duties of a natural person, together with rights and liabilities or both, distinct and apart from those of the persons composing it.

Cost Basis: Cost basis is the dollar amount assigned to the purchase of a specific property at the time of acquisition by the IRS for determining future taxable gains or losses.

Cottage Homes: A home that is typically smaller in size than surrounding homes and may also have a smaller lot.

Counter Flashing: Flashing used on chimneys at roofline to cover shingle flashing and to prevent moisture entry.

Covenant: A promise or agreement to do or not do something such as found in CC&Rs (Covenants, Conditions, and Restrictions) for a condominium.

Crawl Space: Distance between ground level and the first floor of a structure built on a foundation. (18" minimum height.)

Credit: 1. An agreement to receive something of value now while agreeing to pay later, typically with interest. 2. An amount received that is listed on the right side of a statement.

Credit Crisis: A period in which consumers have difficulty getting financing due to economic conditions. The Credit Crises of 2007-08 is also known as the global financial crisis of 2007-08 and the Great Recession. It is considered by many economists to have been the worst financial crisis since the Great Depression.

Credit Rating: the borrower's ability to borrow money at certain rates. The higher the credit rating the lower the interest. Borrower's with the highest credit rating are allowed to borrow at the lowest interest rate, called the "Prime Rate".

CRV: See Certificate of Reasonable Value.

Cul-De-Sac: A street open at one end only; a dead-end street.

Damages: The indemnity recoverable by a person who has sustained an injury either in his/her person, property or relative rights, through the act or default of another.

DBA: Doing Business As

Deal/Concession Close: A “time is money” style of sales approach in that the salesperson implies or clearly states that the prospect will wisely find the best price or value by acting now or today instead of waiting to purchase.

Debit: An amount owed that is listed on the left side of a statement.

Debt-to-Income Ratio (DTI): The percentage of a borrower’s monthly gross income that goes toward paying debts including P.I.T.I. (principle, interest, taxes, and insurance).

Deciduous: Shedding leaves annually; as opposed to evergreen.

Deck: Usually an open porch on the roof or on the ground or lower floor, porch or wing.

Declining Balance: A method of accelerated depreciation allowed by the Internal Revenue Service in special circumstances.

Dedication: The “devotion of the land to public use (for streets, alleys, bridges, parks, squares, wharves, playgrounds, schools, etc.) made by the owner and accepted for such use by or on behalf of the public.” Dedication may be by voluntary or statutory procedure.

Deed in Lieu of Foreclosure : A written deed transfer situation in which a distressed property owner just signs back the deed to their lender to avoid the lengthy and costly foreclosure process.

Deed of Trust: An instrument used to transfer legal title in real property wherein legal title is transferred to a trustee, which holds it as security for a loan (debt) between a borrower and lender. The equitable title remains with the borrower. Also, known as a mortgage.

Deed: A legal document that is signed and delivered, especially one regarding the ownership of property or legal rights.

Default: Failure to fulfill a duty or promise or to discharge an obligation, or to perform any act in an instrument in writing, that has been agreed on. In real estate, it usually refers to the nonpayment of the monthly payment on the trust deed note on a property. A default results in the acceleration clause in the note to be enforced, making all future payments due and payable.

Defeasance: A clause in a deed, lease or other written instrument, the legal effect of which is to defeat, cancel or annul the instrument in whole or in part.

Deferred Maintenance: Existing but unfulfilled requirements for repairs and rehabilitation.

Deficiency Judgment: A judgment given when the security pledged for a loan does not satisfy the debt upon its default.

Demise : The transfer of a right to, or title in an estate; to lease.

Department of Corporations: The main governing body of corporations including escrow companies that are incorporated.

Department of Housing and Urban Development (HUD): The administrative authority in matters involving discrimination in the sale and rental of housing, protection of consumers and work to strengthen the housing market.

Deposit Receipt: The beginning purchase contract for the negotiations to purchase a piece of real property. It is a receipt for the deposit given by the buyer together with the terms under which the buyer is willing to buy. The deposit may be cash, a cashier's check, a note or anything of value. The broker, before obtaining an acceptance to the negotiation, must inform the seller of the form and nature of the deposit given by the buyer. The deposit, no matter what form, belongs to the buyer until the seller accepts the negotiation and the buyer is properly notified of the acceptance. Thereafter, the deposit becomes the property of the seller.

Depreciation: The reduction in value of an asset over time due to wear and tear.

Depth Table: A statistical table that may be used to estimate the value of the added depth of a lot.

Desk Cost: The total current costs including salaries paid to the office manager and receptionist divided by the number of agents in the office.

Deterioration: Reflecting the loss in value brought about by wear and tear, disintegration, use in service, and the actions of the elements.

Devise: A transfer of real property by a will.

Devisee: One who receives real property by a will.

Devisor: One who gives real property by a will.

Diminishing Returns: Refers to a point at which profits or gains has reached its peak. After this peak, increasing contributions will decrease the margin of profits.

Direct Assessment: A bill levied against an individual parcel of land that becomes a lien until paid.

Direct Close: When a salesperson directly asks the prospect to become their client, or to purchase a product or service.

Directional Growth: The trend of development of a city; the direction in which new stores, residences, etc., are being erected.

Discharge: To pay off a debt.

Discount Points: Fees charged to a borrower by a lender in addition to interest. One point is equal to one percent of the loan amount.

Discount Rate: The interest rate a bank must pay to the Fed when the bank borrows money from its bank.

Discretion Powers of Agency: Those powers conferred upon an agent by the principal which empower the agent in certain circumstances to make decisions based on the agent's own judgment.

Discrimination: A practice of choosing to provide more benefits to one race, creed or person of color above any other; or to deny benefits to one over the other. This practice is strictly prohibited by all forms of local state and federal law.

Documentary Transfer Tax: A state enabling act allows cities and counties to adopt a documentary transfer tax to apply on all transfers of real property located within their jurisdictions. Notice of payment is entered on the face of the deed or on a separate paper filed with the deed.

Dodd-Frank Act: Formally known as the Dodd-Frank Wall Street Reform and Consumer Protection Act passed in July 21, 2010 in response to the Great Recession. It changes financial regulations in American financial services industry including the creation of the Consumer Financial Protection Bureau (CFPB).

Dominant Tenement: The property that benefits from an easement.

Donee: One who receives a gift from another.

Donor: A person who makes a gift.

Double Escrow: A real estate transaction involving two buyers where one buyer is selling to the other buyer with arrangements to close on the same day.

Dower: The right which a wife has in her husband's estate at his death.

Downzoning: A public action in which local government authority reduces the allowable density for subsequent development

Dry Rot: A fungus decay causing seasoned lumber to become brittle and crumble to powder. Of all the woods, Redwood is the least susceptible to this condition.

Dry Wall: A wall constructed with dry panels of plywood, fiberboard, gypsum board, etc., which are nailed to the studs, as opposed to a wet or plastered wall.

DTI: See Debt-to-Income Ratio.

Dual Agent: 1. A real estate licensee or multiple licensees who represent both the buyer and seller in a real estate transaction within the same brokerage. 2. The role escrow plays in representing both buyer and seller.

Due-on-Sale Clause: An acceleration clause included within a lender's original financing paperwork which grants the lender the right to call the loan as "all due and payable" due to a borrower's actions such as missed payments.

Duress: Unlawful constraint exercised upon a person whereby he/she is forced to do some act against his/her will.

E. & O. Insurance: Professional liability insurance that protects individuals and companies against claims made by clients for inadequate work or negligent actions.

EA: Exclusive Agency Listing Agreement

Easement: Created by grant or agreement for a specific purpose, and eliminated by quitclaim deed, an easement is the right privilege or interest which one party has in the land of another. Example - right of way.

Easements in Gross: A personal right to use land that is not dependent on ownership of the land. An easement in gross does not transfer when sold unless agreed by both parties. Utility companies often own easements in gross for access.

Easton vs Strausburger: A court finding in 1984 that concluded “Agents are expected to make use of their superior knowledge and skills, which are the reasons they are engaged. The jury was well within the bounds of reason when it concluded that a reasonably competent inspection of the property would have included something more than a casual visual inspection and a general inquiry of owners.”

Eaves: The lower part of a roof projecting over the wall.

Economic Life: The time over which improved property such as a home or apartment building will yield a solid annual return over and above just the value or income of the land.

Economic Obsolescence: This cause of depreciation is said to be extraneous to the property. That is, it is a loss of value caused by an effect outside the property and not by something within the property itself. It is usually “incurable”. If incomes in a neighborhood decrease, it forms economic obsolescence.

Economic Rent: The true market rent paid after subtracting any incentives like one or two month’s free rent, or landlord credits for moving costs, to sign a one-year lease.

EER: When an air conditioning unit has a higher energy efficiency ratio (EER), it means that the unit is more efficient.

Effective Age: The number of years of age that is indicated by the condition of the building.

Effective Gross Income: Gross income after a deduction for a vacancy allowance is deducted. That income used before actual annual expenses are deducted to arrive at net income.

Elevation Plan: A drawing that depicts the architectural style from the north south east and west sides of the building.

Emancipated Minor: In California a person under 18 years of age who by law is treated as an adult in making contracts to buy, sell or lease real or personal property.

Emblements: Typically, annual crops produced by cultivation legally belonging to the tenant with the right to harvest. Crops treated as the tenant’s property.

Eminent Domain: The government’s right to take an individual’s property after paying “fair market value” on behalf of the public for the development or expansion of roads, schools, or parks.

Employee: One who is in such a relationship to another person that the latter may control the work of the former and direct the way it shall be done.

Employer: One who is in such a relationship to another person that he/she may control the work of that person and direct the way it is to be done.

Employing Broker: The broker licensee in a real estate office under whom all other licensees work. The “agent” for all buyer and seller contracts which the office represents as an agent.

Employment Contract: A written contract demanded by real estate law to be kept in the possession of both broker and salesperson during the period of their relationship.

Encroachment: When a structure is improperly built on part of their neighbor’s land.

Encumbrance: Anything which affects or limits the fee simple title to property, such as mortgages, trust deeds, easements or restrictions of any kind which do not prevent alienation of the fee title by the owner. Liens are special encumbrances which make the property security for the debt. "A right in a person who does not own title."

Endorse: To make over to another party the value represented in a check, bill, note or the like, by inscribing one's name on the back of the document.

Endorsement: The signature on the back of a check, bill, note or the like required on negotiable instruments.

Enforceable: That which can be made to be effective; to cause to take effect. An agreement or contract between persons in which one or other party can legally compel the performance of another or other parties.

Engineering Method: An observed condition of estimating accrued depreciation by applying depreciation to individual parts of the structure foundation, walls, floors, plumbing, heating, etc.

EPA: Environmental Protection Agency. Created to protect human health and the environment by writing and enforcing regulations based on laws passed by Congress.

Equal Credit Opportunity Act: A law created to prohibit discrimination based on the sex and marital status of the credit applicant in the extension of credit throughout the United States.

Equity: The interest or value which an owner has in real estate over and above the liens against it.

Equity Loans: Loans secured against property based on the amount of equity held by the borrower.

Erosion: Condition caused by the gradual wearing away of soil by action of the elements or by running water.

Escalation Clause: Written into a real estate purchase contract that states a buyer is willing to increase their offer by a set amount if the seller receives another offer that exceeds their offer.

Escalator Clause: A section of a lease agreement which allows the automatic increase of future rental payments (i.e., a 5% rent increase in year 2) based upon factors such as an increasing consumer price index or inflation numbers.

Escheat: The state acquiring property of persons dying without a will and without heirs. Title is said to "revert to the state."

Escrow: The deposit of instruments and funds with instructions to a third party to carry out the provisions of an agreement or contract. When everything is deposited to enable carrying out the instructions, it is called a complete escrow.

Escrow Agent: A person employed by an escrow company. By law, the agent of both the buyer and the seller during the period it takes to complete an escrow.

Escrow Holder: A disinterested third party authorized to act as the agent of both parties to the escrow.

Escrow Instructions: Instructions to a third party to carry out the terms of a sale, exchange or loan on real property.

Escrow Law: Regulations made to protect the public when working with independent escrow agents in California. Part of the Department of Business Oversight.

Estate: The degree, quantity, nature and extent of interest which a person owns in real property.

Estate at Sufferance: An estate in which the lessee, who has rightfully come into possession of the property, retains possession after the expiration of the term of the agreement without a lessor's consent.

Estate at Will: An estate that is terminable at the will or unilateral decision of the lessor, and at the will of the lessee, with no agreed upon period of duration.

Estate for Life: A possessory, freehold estate in land held by a person (called the life tenant) only for the duration of his/her life or the life or lives of another or others.

Estate for Years: An interest in real property by a contract, possession of which is for a definite and limited period. A lease.

Estate in Remainder: A life estate designated that the title is to go to some other person than the grantor upon the death of the life estate holder.

Estate in Reversion: Property to be returned to the person who gave the life estate, or to his/her heirs at law or beneficiaries.

Estate of Inheritance: An estate which may descend to heirs. All freehold estates are estates of inheritance, except estates for life.

Estoppel: A legal theory under which a person is barred from asserting or denying a fact because of the person's previous acts or words.

Et Al: "Et alii" or "et aliae" are Latin phrases that are commonly used in legal practice. They mean "and others." This phrase is abbreviated very often as "et al."

Et Ux: A Latin term meaning "and wife."

Ethics: Rules of behavior based on ideas about what is morally good and bad.

Eviction: The act of removing a tenant or mortgage borrower from their property due to factors such as missed lease or mortgage payments.

Exchange (Agreement): A means of trading equities in two or more real properties, treated as a single transaction through a single escrow or as a deferred exchange through two or more escrows.

Exchange Value: A market value calculated for each property involved in an exchange.

Exclusive Agency (Listing): A written instrument giving one agent the right for a specified time to sell a property, but reserving the right of the owner to sell the property himself/herself without payment of a commission to the agent.

Exclusive Right to Sell (Listing): A written agreement between an owner and an agent giving the agent the right to collect a commission if the property is sold by anyone during the term of his/her agreement.

Exculpatory Clause: A clause often included in leases that clears or relieves the landlord of liability for personal injury to tenants as well as for property damages. It does not always protect him/her, however, against injury to a third party.

Execute: To complete, to make, to perform, to do, to follow out. To execute a deed is to make a deed, including, the signing, sealing, and delivery; to execute a contract is to perform the contract, to follow it out to the end, to complete it.

Executed Contract: A contract that is fully performed by both parties.

Execution of Contract: To sign a contract.

Executor: A person named in a will to carry out its provisions as to the disposition of the estate of a deceased person.

Executor's Deed: A legal deed to real property given by an executor of an estate.

Executory Contract: A contract not yet fully performed.

Executrix: A female executor of a will.

Expandable House: Home designed for further expansion and addition in the future.

Expansion Joint: A bituminous fiber strip used to separate units of concrete to prevent cracking due to expansion because of temperature changes.

Express Authority: An agency relationship created and confirmed after an appointed real estate agent has been expressly informed, either verbally or in a written contract, their expected specific and defined roles in a transaction.

Extended Title Policy: Standard policies of title insurance with additional coverage that may include risks found through physical inspections, unrecorded liens, leasehold interests, and land contracts.

EZ Doc: Loans that require much less paperwork and documentation.

Façade: Front of a building.

Fact, Bridge, Benefit Technique: A sales technique used by detailing facts or points which then “bridge” or connect to the prospect’s needs or interest.

Failure to Disclose: The failure to disclose a fact material to the transaction, whether to buyer or seller, is fraud in California.

Fair Credit Reporting Act (FCRA): Federal law to promote the accuracy, fairness, and privacy of information in files of consumer reporting agencies.

Fair Employment and Housing Commission: The state agency charged with enforcing California’s civil rights laws. The mission of the Department of Fair Employment and Housing (DFEH) is to protect the people of California from unlawful discrimination in employment, housing and public accommodations and from hate violence and human trafficking.

Fannie Mae: Federal National Mortgage Association. One of the largest secondary market investors that is now primarily owned and controlled by the federal government.

Farm: An area in which a salesperson is searching for clients. It may be based on a geographical area or a list of potential clients.

FAT: A formula used to analyze real estate investments – Financing, Appreciation & Tax Savings Flexibility.

Feasibility Study: An analysis of the cost/benefit ratio of an economic endeavor.

Federal Civil Rights Act of 1968: National law that prohibits discrimination by property owners, real estate agents, property managers, and their clients. This act was based upon the U.S. Supreme Court decision in the Jones v. Meyer case which upheld and supported the Civil Rights Act of 1866 and was included with Title VIII of the Civil Rights Act of 1968.

Federal Reserve Act: Created by an Act of Congress to create and establish the Federal Reserve System, the central banking system of the United States, and the authority of banks to issue US dollars.

Federal Reserve Bank System: The central bank of the United States. Created by the Congress to provide the nation with a safer, more flexible, and more stable monetary and financial system. Also called the “Fed”.

Federal Trade Commission: An independent federal agency designed to protect consumers and enforce consumer protection and antitrust laws.

Fee: An estate of inheritance in real property.

Fee Appraiser: An appraiser who prepares appraisals for a fee. Usually a certified appraiser and a person with the education credentials and the experience to appear as an expert in court testimony.

Fee Simple Absolute: An estate in real property by which the owner has the greatest power over the title which it is possible to have, being an absolute estate. A fee simple absolute is free of any deed restrictions.

Fee Simple Conditional: An estate in real property that is restricted, as a rule, to one purpose only.

Fee Simple Estate: A near complete or absolute right to use, encumber, or sell one’s property without any major restrictions.

FHA: The Federal Housing Administration is part of HUD that insures loans so that lenders can provide more funding for home loans.

FHFA: The Federal Housing Finance Agency was created as part of the Federal Housing Finance Regulatory Reform Act of 2008 to assist with management and delinquent asset sales for Fannie Mae, Freddie Mac and other financial entities.

FICO: Fair Isaac Corporation. A uniform and consistent measurement of credit reporting and scoring system used by the three major credit reporting bureaus (Experian, Transunion and Equifax).

Fiduciary Duty: That duty owed by an agent to act in the highest good faith towards the principal and not to obtain any advantage over the latter by the slightest misrepresentation, concealment, duress or pressure.

Fiduciary: A person who holds a legal or ethical relationship of trust with one or more parties.

Final Public Report: Subdivisions under DRE jurisdiction may not be offered for sale or lease until a final public report is obtained.

Financial Disintermediation: When the flow of investment funds moves out of financial institutions into the market for other financial assets.

Fire Stop: A solid, tight closure of a concealed space, placed to prevent the spread of fire and smoke through such a space.

Firm Commitment: An agreement for a lender to lend that usually follows a Conditional Commitment once all conditions have been satisfied.

FIRREA: The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 is a United States federal law enacted because of the savings and loan crises of the 1980's.

Fiscal Year: An accounting year that typically does not run from January 1 to December 31.

Fixtures: Anything affixed to the land when it is attached to it by roots, as in the case of trees, vines or shrubs; imbedded in it, as in the case of walls; permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent as by means of cement, plaster, nails, bolts or screws.

Flashing: Sheet metal or other material used to protect a building from seepage of water.

Flat Lease: (Also called a fixed lease or straight lease) A lease which requires that the same amount of rent be paid periodically for the entire term of the lease.

Footing: The base or bottom of a foundation wall, pier, or column.

Foreclosure: Procedure whereby property pledged as security for a debt is sold to pay the debt in event of default in payments or terms.

Forfeiture: Loss of money or anything of value due to failure to perform, such as a deposit given to insure performance.

Foundation: The supporting portion of a structure below the first-floor construction, or below grade, including the footings.

Foundation Plan: A drawing which discloses features including piers, footings, and columns.

Franchisee: An individual or company that holds a franchise for the sale of goods or services.

Franchisor: An individual or company that grants a license to a third party for conducting a business under the franchise.

Fraud: The intentional and successful employment of cunning, deception, collusion; or artifice used to cheat or deceive another person whereby that person acts upon it to the loss of his/her property and to his/her legal injury.

Freddie Mac: Federal Home Loan Mortgage Corporation created in 1970 by the federal government as another type of secondary market investor.

Freehold Estate: A quality of ownership indicating the holding of title. All other interests in real property are less than freehold.

Front Foot: The front linear foot of a property in relation to the street line.

Front-end DTI: A loan qualification formula used by most lenders that calculates the debt-to-income ratio (DTI) by taking the proposed PITI divided into the borrower's gross monthly income.

Frost Line: The depth of frost penetration in the soil. Varies in different parts of the country. Footings should be placed below this depth to prevent movement.

Fructus Naturales: Emblems including trees, shrubs, vines and crops that are produced by nature alone, and are ordinarily considered to be a part of the land to which they are attached until they are removed, at which time they become personal property. Fructus naturales can be owned separately from the land.

Functional Obsolescence: The economic loss in a property value due to older, outdated design such as a home with just one bathroom.

Functional Utility: The sum of a property's attractiveness and usefulness. These characteristics are found more properly in the property itself rather than in the minds of the occupants.

Furring: Strips of wood or metal applied to a wall or other surface to even it, to form an air space, or to give the wall an appearance of greater thickness.

Gable Roof: A pitched roof with two sloping sides.

Gambrel Roof: A curb roof, having a steep lower slope with a flatter upper slope above.

General Agent: The most broad and wide-ranging type of agency on behalf of a client.

General Lien: A lien on all the property of the debtor. Usually tax liens and judgments.

General Plan: A comprehensive, long range official plan that guides the physical growth and development of a community combined with the basic regulatory and administrative controls needed to attain the physical objective. Also, called Master Plan, City Plan, or Comprehensive Community Plan.

Generation X: The generation born after the World War II baby boom from the early 1960s to the early 1980s.

Generation Y/Millennials: The generation born between 1981 and 1996. Most of this generation reached adulthood around 2000 and are also known as Generation Y.

Generation Z: The generation born between 1995 and 2010. Currently the largest generational group in the world.

Gift Deed: A grantor may make a gift of property to the grantee using a grant deed or quitclaim deed form. A grantor may (but need not) say the transfer is made in consideration of "love and affection."

Ginnie Mae: Government National Mortgage Association created in 1970 as a secondary market investor specializing in government -backed mortgage loans.

Girder: A large beam used to support beams, joists and partitions.

Golden Rule: The most familiar version says, "Do unto others as you would have them do unto you."

Good Funds: Checks and money orders that have been cleared by a bank into liquid funds.

Goodwill: An intangible but saleable asset of a business derived from the expectation of continued public patronage.

Grade: Ground level at the foundation.

Graded (Set-Up) Lease: A type of long-term lease in which one or more increases in rent are provided for the rental, then becoming a fixed sum each year for the remainder of the term.

Graduated Lease: A type of long-term lease agreement which provides for a fixed rental fee during the initial period of the lease with increases and/or decreases in rental amount at stated times during the balance of the contract term. (such agreements are sometimes called “step up leases” or “step down leases.”)

Grant: A technical term used in deeds of conveyance of lands. When used all alone, title is to be warranted or guaranteed by implication.

Grant Deed: A deed in which the grantor uses the words “I grant” as the action or transfer word. A grant deed is used only once. It is not an assignable or negotiable instrument.

Grantee: A person to whom real property has been transferred or granted typically by way of a grant deed.

Grantor: The person who sold, conveyed, transferred, or granted property to another person or entity.

Gratuitous Agent: An agent who works without compensation. Consideration is not required to establish this agency relationship.

Greatest Generation: A term coined by Tom Brokaw in his book, *The Greatest Generation*, used to describe those who grew up during the Great Depression and fought World War II, or whose labor helped win it.

Gross Income: Total income from property before any deductions.

Gross Lease: A lease which obligates the lessor to pay all or part of the expenses of the leased property, such as utilities, fire insurance, maintenance, real property taxes, etc.

Gross Multiplier: The ratio of the price of a real estate investment to its annual rental income before accounting for expenses such as property taxes, insurance, utilities, etc.

Ground Rent: Earnings of improved property credited to earnings of the ground itself after allowance is made for earnings of improvements.

Guarantee of Title: The confirmation of good title for a property after a thorough review of public records, including the chain of title.

Hard Money Loan : A type of private money loan with higher than market fees and rates than conventional loans, and loans which usually fund much quicker due to easier underwriting methods.

Header: A framing member, usually of one or more pieces of lumber, placed over an opening in a wall.

HELOC: Term used by lenders for a home equity line of credit.

Highest and Best Use: An appraisal and development method where one or more real estate specialists determine or forecast the most lucrative and profitable way to own or build on a real estate site.

Hip Roof: A pitched roof with sloping sides and ends.

Holden Act: Prohibits discrimination in real estate lending. Also known as the Housing Financial Discrimination Act.

Holder in Due Course: One who has taken a note, check, or bill of exchange in due course, (1) before it was overdue, (2) in good faith for value, (3) without knowledge that it has been previously dishonored, (4) without notice of any defect at the time it was negotiated to him/her.

Holdover Tenant: A tenant occupant who stays beyond the expiration of his/her lease term.

Home Debt Income Ratio: See Debt-to-Income Ratio.

Homeowner Guide to Earthquake Safety: Required by law to be distributed to buyers and sellers of all properties comprised of one-to-four units.

Homeowner's Exemption: An exemption of \$7,000 in assessed value from the property tax assessment of any California property owned and occupied as the owner's principal place of residence which reduces the annual property tax bill by \$70.

Homestead: A home upon which the owner or owners have recorded a Declaration of Homestead, as provided by California statutes; protects home against judgments up to specified amounts.

HUD: The Department of Housing and Urban Development is an agency of the federal government that provides housing and economic development while overseeing discrimination in housing and lending.

HUD-1: A document listing charges and credits to the buyer and seller in a real estate transaction. As of October 3, 2015, it has been replaced by a Closing Disclosure.

Hundred Percent Location: A city retail business location which is considered the best available for attracting business.

Hypothecate: To pledge a property to another person as security for a loan or for some other factor without giving up the possession of the same property.

Implied Authority: Agency relationship between a principal and agent based upon a presumption of agency authority due to the history of the parties or by way of actions and behaviors.

Implied: Presumed agreements based upon the words or behaviors of another person as opposed to expressed or written agreements.

Impound Account: Monies held in trust by lender for payment of taxes and insurance.

Improved Value: The combined value of land and building, as distinguished from their separate values.

Income Property: Property which produces income from residential or commercial rentals, and profits attributable to real estate other than rent.

Incompetent: One who is mentally incompetent, or incapable. Any person who, though not insane, is, due to old age, disease, weakness of mind, or any other cause, unable, unassisted, to properly manage and take care of himself/herself or his/her property.

Indirect Lighting: The light that is reflected from the ceiling or other object external to the fixture.

Industrialization: A period of economic change from an agrarian society to an industrial one.

Inflation Hedge: An investment that is considered to provide protection against the decreased value of an asset by maintain or increasing its value over a specific period.

Ingress: A way to enter onto a property.

Injunction: A writ or order issued under the seal of a court to restrain one or more parties to a suit or proceeding from doing an act which is deemed to be inequitable or unjust regarding the rights of some other party or parties to the suit.

Installment Note: A promissory note (or "IOU") which provides for the payment of two or more equal monthly installments.

Installment Plan: Also known as amortization. A note which provides that payments of a certain sum or amount be paid on the dates specified in the instrument. In real estate, 99% of the time a note backed by a trust deed as security calls for amortized interest.

Installment Sales Contract: An agreement for the purchase and sale of real property that calls for regular payments to allow deferral of capital gains tax.

Institute of Real Estate Management (IREM): One of the earliest U.S. property management associations formed to bring more stability, integrity, uniformity with national rules, guidelines, and laws to the field of real estate. NAR later took over governance of this group.

Institutional Lenders: Lenders in the secondary mortgage market including banks, life insurance companies, and pension funds.

Instrument: A legal document in writing to create, alter, secure, modify or terminate a right.

Insurable Value: A value determined by insurance companies for policy coverage and benefits.

Intangible Value: A value not imputable to any part of the physical property, such as the excess value of a favorable lease, or the value attributable to goodwill.

Intention of Interested Parties: One way to determine real or personal property that may include an agreement between parties about the fixture.

Interest Rate: The percentage of a sum of money charged for its use. Rent or charge paid for the use of money, expressed as a percentage, usually per year, of the sum borrowed. The interest rate on any loan varies with the type of loan and the insurance or guarantees that back the repayment of the debt. Example - FHA loans carry a lower interest rate than conventional loans because the lender is insured against loss.

Interest-Only Loan: Also called a straight note, calls for interest only payments for a fixed period then calls for a balloon payment of the entire face value of the note.

Interim Loan: A short-term, temporary loan such as a construction loan which is later paid off with longer term permanent financing.

Internet Penetration: The percentage of a total population that uses the internet.

Interpleader Action: A civil procedure that allows a party to initiate a lawsuit to compel two or more parties to litigate a dispute.

Intestate: A person who dies without having made a will, or one which is defective in form, in which case his/her estate descends to his/her heirs at law or next of kin.

Intestate Succession: Inherit through court action, by heirs, by state law. Is required if the individual who died did not leave a will.

Inventory: An itemized list of the stock in trade and/or the fixtures used in a business.

Investment: Money put in property or other ventures with the expectation of making a profit, with sufficient security to return and protect the capital sum; not speculation.

Investment Value: An analysis of an asset based on income, expenses, vacancy factor, and NOI.

Involuntary Conveyance: Sheriff's deed; tax deed; an instrument against the will of the owner.

Involuntary Lien: A lien imposed against property without consent of owner, e.g., assessments, federal income tax liens, judgments, etc.

Irrigation District: A district created under a special law for the purpose of developing and furnishing water, primarily for agricultural purposes.

Jamb: The side post or lining of a doorway, window or other opening.

Joint: The space between the adjacent surfaces of two components joined and held together by nails, glue, cement, mortar, etc.

Joint and Several Note: A note signed by two or more persons, the makers of which may be sued either jointly or individually for the full amount of the note.

Joint Note: A note signed by two or more persons with equal liability for payment.

Joint Tenancy: Joint ownership by two or more persons with right of survivorship which means that a joint tenant cannot will their share of the tenancy. Should any joint tenant die their share automatically passes, without any court action, to the remaining joint tenant(s)

Joint Tenants: Two or more owners of a property that share equal interest in a property such as rights of possession. Upon the death of one of the joint tenants, title will pass automatically to the other joint tenants still on the deed.

Joint Venture: The ownership of real property or a much larger development project by two or more parties or entities.

Joists: A series of parallel wooden members used to support floor and ceiling loads to which the boards of a floor and ceiling laths are nailed, and supported in turn by larger beams, girders, or bearing walls.

Jones vs. Mayer: The United States Supreme Court reaffirmed the constitutionality of the Civil Rights Act of 1866 prohibiting racial discrimination in the sale and leasing of real property.

Judgment: A monetary lien from a court order or verdict. Can also come from a governing tax office for unpaid state or federal tax liens, and other private or government groups.

Junior Lien: A lien in 2nd, 3rd, or 4th + position behind an existing 1st lien on real property such as a delinquent property tax payment.

Junior Mortgage: A mortgage filed in 2nd + position subsequently after the original mortgage funded at the time of the purchase or refinanced later.

Jurisdiction: A local, state, or federal court's power to hear a legal dispute prior to issuing a ruling, decision, or verdict by way of a judge or jury.

Kiosk: A freestanding booth in a parking lot or a shopping mall. Film processing booths and key shops located in these areas are examples of kiosks.

Known False Statement: If an individual does make a statement, intentionally, with knowledge of its inaccuracy or makes the statement having cause to doubt its accuracy, then the statement is fraud.

Laches: Delay or negligence in asserting one's legal rights.

Land Brokers: Agents that specialize in the sale and development of raw land.

Land Contract: An agreement for the purchase or sale of real property used to transfer property without recording a grant deed.

Land Entitlement: Adding value to raw land by gathering the necessary building paperwork, paying filing fees, and making development improvements.

Land Locators: Licensed agents assisting others for compensation in locating, acquiring or leasing public lands.

Land Projects: A 1969 state law dealing with subdivision development of 50 or more unimproved lots in a rural area with less than 1500 registered voters within the subdivision or within two miles of the subdivision.

Landlocked: Land with no to minimal access to roads or highways due to factors such as isolated locations, easements, encroachments, or poor design.

Lath: A building material of wood, metal, gypsum, or insulating board fastened to the frame of a building to act as a plaster base.

Lead Paint: Added to paint for color, to speed drying and increase durability prior to 1978 when it was determined to be an environmental hazard.

Lease: A contract between the owner of real property, called the lessor, and another person, called the lessee, covering conditions under which the lessee may gain possession and use the property. A lease does not transfer any title to the property.

Lease with Option to Purchase: A lease that provides for the purchase of the property by the lessee during the term of the lease, if the lessee so desires, with price and terms stated.

Leasehold: A temporary right to hold land or property in which a lessee or a tenant holds rights of real property from a lessor or landlord.

Legacy: The gifting of personal property or money by way of a will, trust, or some other type of beneficial contract.

Legal Capacity: Power provided under law to an individual to enter binding contracts.

Legal Consent: For a legal agency relationship to exist the parties must have mental capacity, no duress, and willingness to enter.

Legal Description: A type of legal and numerical address description based upon governmental surveys, county records, recorded maps, and/or the county assessor's office.

Legal Presence: Satisfactory proof for a real estate license that an applicant's presence in the United States is authorized under federal law. No longer a requirement for a CA real estate license as of January 1, 2016.

Legality: Before a contract can come into existence, the object of the contract must be legal or lawful. An agreement to do something prohibited by law cannot be a contract.

Legatee: One to whom personal property is given by will.

Lender's Policy: A policy of title insurance that insures the mortgagee (lender) against loss caused by defective title. It does not protect the buyer.

Lessee: One who contracts to rent property under a lease agreement.

Lessor: An owner who enters a lease with a tenant.

Less than-freehold: An estate held by one who rents or leases property. It is also known as a leasehold estate. A leasehold estate is an ownership interest in land in which a lessee or a tenant holds real property by agreement from a lessor or landlord.

Letter Form Report: This type of report is generally used when the client is familiar with the area and supporting data are not necessary. It consists of a brief description of the property, the purpose of the appraisal, the date of the value estimate, the value conclusion, and the signature of the appraiser.

Leverage: The use of a small amount of cash to control a large amount of property values.

License: A revocable right for a person to use real property belonging to another.

LIDS: A formula used to analyze anticipated appreciation by using Legislation, Inflation, Demand, and Supply components.

Lien: A charge or encumbrance upon property for the payment or discharge of a debt.

Life Estate: An interest in real property which is held for the duration of the life of some certain person. It may be limited by the life of the person holding it or by the life of some other person. During the life estate, the holder can lease the property or encumber it by trust deed but only for the period of the life of the life estate holder.

Life Insurance Company: Issues a policy wherein the insurance premium will pay the entire amount of the policy if the insured dies during the existence of the policy. Life insurance companies have most of their assets in long-term real estate loans. They use Mortgage Bankers to obtain the loans because they do not want the responsibility of collections and the other details concerning the day to day maintenance of the loans they make. They are most interested in the largest loans.

Life Tenant: The holder of a life estate.

Like-kind: Used in IRC #1031 exchanges to describe the type of asset required to be exchanged. An investment duplex is considered like-kind to a fourplex or vacant land but not personal property or a business opportunity.

Limited Partnership Act: 2008 California law that allows a limited partner to not be liable as a general partner unless the limited partner is named as a general partner in the Certificate of Limited Partnership or the limited partner participates in the control of the business.

Lineal: Pertains to direct line of descendants.

Lintel: A horizontal board that supports the load over an opening such as a door or window. Can also be metal, if supporting brick or masonry. Like "header."

Liquidate: Disposal of property or settlement of debts.

Liquidated Damages Clause: A clause found in purchase agreements that specifies an amount of money that must be paid as damages for failure to perform.

Liquidity: How fast it takes to convert an investment, securities, or savings account to cash.

Lis Pendens: A Latin expression meaning “litigation pending.” It is recorded to cloud the title in a lawsuit affecting real property.

Listing: An employment contract between owner and broker authorizing the broker to perform services involving the principal’s property.

Listing Agent: A real estate salesperson that is representing the seller.

Littoral Waters: Coastal waters, whether of the sea or a lake.

Live Load: Floor joists are required to support a live load of at least 40 pounds per square foot, and a roof must support a live load of at least 20 pounds per square foot.

LLC: Limited Liability Corporation. It is a legal form of a company that provides limited liability to its owners.

Loan Estimate: A 3-page form required by TRID as of October 3, 2015 that must be given to borrowers within 3 business days of receiving a mortgage loan application.

Loan-To-Value Ratio: The relationship between the total value of a property and the percentage of that value that the loan has. If the loan-to-value is low the equity of the owner in the property is high. If the loan-to-value is high the equity of the owner in the property is low.

Locked-In Clause: A clause in a trust deed or mortgage prohibiting its prepayment before a specified time.

Louver: An opening with a series of horizontal slats set at an angle to permit ventilation without admitting rain, or sunlight.

M.A.I.: Designates a person who is a member of the American Institute of Real Estate Appraisers.

MACRS: Modified Accelerated Cost Recovery System - a method used to depreciate residential rental property placed in service after 1986.

Manufactured Home: A structure transportable in one or more sections, designed and equipped to contain no more than two dwelling units to be used with or without a foundation system. Also, known as a mobilehome.

Marginal Land: Land which barely pays the cost of working or using it.

MARIA: The legal distinction between real and personal property can be best remembered by the MARIA acronym - Method of attachment, Adaptability, Relationship of the parties, Intention, Agreement of parties.

Market Approach: The most used appraisal technique comparing price, value, utility and location in relation to other comparable property in the same or similar type neighborhood.

Market Price: The price the property brings after marketing.

Market Value: The price a willing buyer would pay and a willing seller would accept, both being fully informed and property exposed for a reasonable time.

Marketable Title: Property that is readily transferable since it is free from valid claims by outside parties and does not have any defects of title.

Material: Information is material if it would in any way affect a decision of the seller made during the transaction. Material facts must be disclosed and are those known by the agent, or should be known by the agent.

Maturity: In the language of real estate professionals, a property is said to have reach “maturity” when the overall operation of the property is beginning to show a profit.

Mechanic’s Lien: A type of statutory lien filed by contractors, subcontractors, or others for the payment of their work or services performed during the construction or remodel of one or more properties.

Megalopolis: A heavily populated continuous urban area including any number of cities.

Mello-Roos: Special bond or tax assessments paid by homeowners in newer development regions. Named after California legislators.

Meridians: The imaginary north and south lines which intersect with east to west lines to create a legal measurement for land.

Mesne High Tide: The average high tide line.

Metes and Bounds: A legal designation used in describing the boundary lines of a parcel of land.

Method of Attachment: One of the ways to determine real or personal property. Items on a property that are permanently attached are typically considered real property while movable items are considered personal property.

Middleman: An individual with limited authority, having no power to negotiate the terms on which the principals will deal. Typically defined as someone arranging an introduction between parties.

Migration: The tendency of people to lift their roots and readily travel anywhere with little restraint.

Minimum Areas: In every dwelling at least one room must have no less than 120 square feet of superficial floor area. Every other habitable room except the kitchen or breakfast room must have 90 square feet of floor area.

Minor: Any person under the age of 18; any person under the age of 21 in regard to the use of alcoholic beverages and tobacco.

Misrepresentation: A false or misleading statement made by someone like a licensed real estate agent to their clients or to the public by way of an online or printed advertisement.

Mixed Use: A type of zoning that allows different zoning on one or more parcels. For example - a multistory apartment with commercial stores on the first level.

MLS: Multiple Listing Service. A suite of services that enables real estate brokers to establish contractual offers of compensation and cooperation with other broker participants to sell real estate.

Mobilehome: A structure transportable in one or more sections, designed and equipped to contain no more than two dwelling units to be used with or without a foundation system. Also, known as a manufactured home.

Mold: A fungus that grows in the form of multicellular filaments called hyphae.

Molding: Usually patterned strips used to provide ornamental variations of outline or contour, such as cornices, bases, window and door jambs.

Monument: A fixed object and point established by surveyors to establish land locations.

Moratorium: Temporary suspension, usually by statute, of the enforcement of liability for an obligation.

Mortgage: An instrument used to transfer legal title in real property wherein legal title is transferred to a trustee, which holds it as security for a loan (debt) between a borrower and lender. The equitable title remains with the borrower. Also, known as a trust deed.

Mortgage Banker: A company, individual or institution that originates real estate loans by using own funds, or funds borrowed from a warehouse lender, to fund mortgages.

Mortgage Loan Broker: A company, individual or institution that acts as an intermediary by brokering mortgage loans on behalf of individuals or businesses.

Mortgage Warehousing: Placing many trust deeds or mortgages with a lender as security on a loan.

Mortgagee: The lender who receives the beneficial interests or payments related to a mortgage loan.

Mortgagor: One who borrows money on his/her property and gives a mortgage as security.

Multifamily Apartments: Property consisting of 5 or more apartment units.

Multiple Listing: A listing, usually an exclusive right to sell, taken by a member of an organization of brokers, with provision that all members will have the opportunity to find an interested purchaser.

Mutual Consent: Parties to a contract must agree on the exact same thing.

Mutual Water Company: A water company organized by or for water users in each district with the object of securing an ample water supply at a reasonable rate; stock issued to users.

NAR: National Association of REALTORS®. America's largest trade association, representing over 1 million members involved in residential and commercial real estate founded in 1909.

Narrative Report: The longest and most complete appraisal report. It includes all pertinent information about the area and the subject property, as well as the reasons and computations for the value conclusions. It includes maps, photographs, charts, elevation, foundation, floor and plot plans.

National Apartment Association (NAA): A non-profit trade association of apartment owners and suppliers throughout the United States and Canada.

Natural Hazard Disclosures: The Natural Hazards Disclosure Act (Se. 1103 CA CC) states that real estate sellers and brokers are legally required to disclose if the property being sold is within one or more state or locally mapped hazard areas.

NDFAs: November 1st, December 10th, February 1st, April 10th- Important tax months when property taxes are due or become delinquent.

Negative Amortization: When the monthly payment is not sufficient to cover the interest amount of the loan, the non paid interest will be added to the principal amount of the loan increasing the principal amount of the loan.

Negligent Fraud: A positive statement of fact by an agent in which he/she does not have sufficient information to justify such an assertion. Negligent fraud subjects a licensee to disciplinary action, civil action and possibly criminal action.

Negotiable: Capable of being negotiated assignable or transferable in the ordinary course of business.

Net Income: The true income received by a property owner by taking their estimated gross income prior to subtracting their actual expenses.

Net Lease: It is a common type of commercial lease situation for office and retail properties where the tenant pays a fixed lease payment plus additional expenses such as maintenance, property taxes, and/or insurance.

Net Listing: A listing which provides that the agent may retain, as compensation for his/her services, all sums received over and above a net price to the owner.

Net Operating Income: See NOI.

Net Profit: The amount of money left after covering expenses and taxes.

Net Rental Area: The net rental area of office space is considered as the rental space between the outside wall and the corridor wall. The appraiser's primary measure of the efficiency of an office building plan is the ratio of net rentable area to gross floor area.

Net Worth: The amount of wealth that a person, business, or some other type of entity such as a corporation or partnership has after subtracting the total assets by outstanding liabilities.

Neutral Escrow: An escrow business conducted by a person licensed by law to act in this capacity.

New Deal: President Roosevelt's program consisting of the 3R's (Relief, Recovery and Reform).

NOI: The net operating income (NOI) is found by deducting all expenses from the gross income.

No-Fault Divorce: A California divorce does not require marital misconduct on either side. Either spouse may claim incompatibility or irreconcilable differences.

Non-Assignable: Usually referring to a contract. Example - A land contract is assignable. A listing, because it is a personal service contract, is non-assignable.

Nonconforming Use: A use that was lawfully established and maintained, but no longer conforms to the use regulations of the zone in which it is located because of a subsequent change in a zoning ordinance.

Non institutional Lenders: Conventional loans secured from private individuals, pension funds, endowed universities and colleges, mortgage investment companies, trust departments of banks, executors of estates, and others who have funds entrusted to them for investment. They are the greatest source of secondary or junior financing.

Notary Public: An official authorized by law to witness or attest to an acknowledgment by a person who has executed an instrument.

Note: A signed written instrument acknowledging a debt and promising payment. Used mainly as the evidence of a debt when borrowing money. Also, used in real estate infrequently as a deposit in making an offer to purchase. If a note is so used, the broker must inform the seller of the nature of the deposit before acceptance. (See Deposit Receipt)

Notice of Bulk Transfers: A notice required by law to be recorded at least 12 business days prior to the sale or mortgage of a business.

Notice of Completion: The public notice filed after the construction of a new dwelling such as a home or commercial property has been finished.

Notice of Default (NOD): The first step in the foreclosure process when the borrower is officially notified of late payment.

Notice of Non-Responsibility: A notice provided by law designed to relieve a property owner from responsibility for the cost of improvements ordered by another person.

Notice of Trustee Sale: A part of the foreclosure process when the borrower is officially notified by the trustee at least 20 days prior to the sale date.

Notice to Pay Rent or Quit: An official notice for unpaid and delinquent rental payments, or the demand that the tenant vacates within the next few days (aka “three-day notice”) or some other mutually agreed upon time.

Novation: The substitution of a new obligation for an old one.

Oath: A declaration using the name of God to act as the judge that you will do that for which the oath is taken. This could be an “oath of public office” or the oath of a witness in a trial. If a person will not take an oath using the name of God because of religious beliefs, that person can make a written “Affidavit” and have that affidavit witnessed by an officer of a court who has the right to administer an oath.

Obligatory Advances: Installment payments of a loan from lender to a contractor.

Obsolescence Loss in value due to reduced desirability and usefulness of a structure because it has become old fashioned and not in keeping with modern needs, or because of adverse social or economic influences.

Offer: A contract to purchase now (deposit receipt) or a right to purchase in the future (option). When accepted, it no longer remains what it says it is. A deposit receipt becomes an agreement of sale, or offer and acceptance. An accepted offer to purchase in the future, in effect, becomes a legal option.

Offer and Acceptance: A contract used in the sale of real property; a purchase agreement or exchange agreement. It is only valid when signed by all contracting parties.

Office Policy Manual: A compilation of a real estate company's mission, goals, procedures and policies prepared to give sales associates a solid understanding of their company.

Offset Statement: A statement by owner of property or owner of lien against property, setting forth the present status of liens against said property.

One Hundred Percent Financing: An acquisition of property with no down payment. Available in a buyer's market by having the buyer assume the seller's loans and taking title, or having the seller carry back a second trust deed for the total equity. Also, available under the VA by purchasing at a price that is equal to, or less than, the CRV.

One Hundred Percent Location: The best possible location for a merchant to have a store.

Open Housing/Fair Housing Laws of 1968: Congress attempted to establish that in the sale and rental of housing accommodations, all persons are to be treated equally. to prevent discrimination because of race, color, religion or national origin in the sale or rental of housing units.

Open Listing: A non-exclusive listing where only the agent who brings in the buyer gets paid a commission.

Open Market Operations: The Fed buys and sells government securities to influence the amount of available credit. When the Fed buys government securities from the public, it stimulates the economy.

Open Space Land: Land used for agriculture, recreation, scenic beauty, natural resources, water shed or wild life, and so designated on a map.

Open-End Mortgage: One which provides that the outstanding balance can be increased to advance additional loan funds to the borrower, up to the original sum of the note.

Opinion of Value: Definition of an appraisal. Also, used by real estate agents without an appraiser's license when evaluating real estate.

Option: A right offered to a potential buyer or tenant to later purchase a property under previously mutually agreed upon terms as well as within a defined period.

Optionee: The person offered the option to purchase by the seller or landlord in a transaction like a lease with an option to purchase the home.

Optionor: A seller or landlord who agrees to give an option to purchase their property to another person such as their tenant or to a prospective buyer who needs more time to find the right financing options.

Oral Contract: A verbal agreement; one which is not reduced to writing.

Orderly Process: Steps undertaken by professional appraisers in their valuation process to arrive at an accurate valuation.

Orientation: The positioning of a structure on a lot considering exposure to the sun and prevailing winds, privacy, and protection from noise.

Ostensible Agency: An agency relationship created when the principal intentionally, or by want of ordinary care, causes a third person to believe another to be his/her agent.

Ostensible Authority: The authority which a third person reasonably believes an agent possesses because of the acts or omission of the principal.

Overhang: The part of the roof extending beyond the walls to shade buildings and cover walks.

Owner's Policy: A type of title insurance that protects the owner from defects in title including previous fraudulent transfers, past tax liens, past judgments, past mechanic's liens, or overlooked defects found in public records. Also, known as a Standard Title Policy.

Package Trust Deed (Mortgage): Security for a loan that covers real and personal property.

Panic Selling: Also referred to as blockbusting, is a method of inducing or attempting to induce any person to sell or to rent any dwelling on the grounds of a potential loss of value, due to the present or anticipated entry into the neighborhood of persons of another race, color, religion, ancestry or national origin.

Parquet Floor: Hardwood flooring laid in squares or patterns.

Partial Reconveyance: A release of a portion of a property or properties collateralized by one mortgage or a "blanket mortgage" on two or more properties from a loan and / or a deed of trust.

Partial Release Clause: A clause in a blanket mortgage which provides that, upon payment of a certain agreed upon amount, individual parcels will be released to the trustor, free and clear of the blanket encumbrance, thus permitting a partial reconveyance of the encumbered property.

Partnership: The voluntary association of two or more people or entities acting as co-owners of one or more properties.

Party Wall: The dividing wall between two adjacent properties.

Patent Ambiguity: An uncertainty which appears on the face of an instrument is identified as a patent ambiguity or defect.

Patent: A grant from a sovereign. In American Law, the instrument by which a state or government grants public land to an individual.

Patio Home: Homes built in higher density suburban locations such as golf course and other gated communities. Also, known as Garden Home, Villa, Courtyard or Club Home.

Penny: Size of nails such as one-penny, three penny, etc.

Per Se: means, of itself, taken alone, unconnected with other matters.

Percentage Lease: A lease on property in which the rent is determined by the amount of business done by the lessee; usually a percentage of gross sales from the business with a provision for a minimum rental.

Percolation: The seepage of water through soil; the soil's ability to absorb to water or other liquid.

Periodic Tenancy: An estate from period-to-period (either year to year, month to month, or week to-week) as designated by lessor and lessee in their agreement.

Personal Property: Movable property that does not include real property (land and buildings).

Pest Control Report: The legal name for a termite report. This report is obtained by the seller at the seller's expense and any work to be done on the property is at the seller's expense. A property needing termite work is a negative element in a sale. Good sales techniques teach that the report and work should be done by the seller either prior to listing the property or immediately upon listing the property so that the agent, when asked if the property has any termite problems, can quite truthfully answer "no," and will have a Pest Control Report on hand to prove his/her point.

Physical Depreciation: Also called functional obsolescence. As a building gets older, it loses its value because it simply wears out, and contains old fixtures, plumbing, and wiring.

Physical Deterioration: A loss of value brought about by wear and disintegration, use in service, and the action of the elements,

Physical Life: The estimated period during which a physical thing may be capable of use if normally maintained.

Pier: A column of masonry, usually rectangular in horizontal cross section, used to support other structural members.

Pitch: The incline or rise of a roof (4" to every foot for wood shingles.) Pitched roofs last longer than flat roofs.

PITI: The sum including principle, interest, taxes and insurance of a mortgage.

Planned Development: Five or more individually owned lots where one or more other parcels are owned in common, or there are reciprocal rights in one or more other parcels. A subdivision.

Planning and Zoning Commission: An elected or appointed board charged with recommending zoning and development standards within the city or community to the town or city council.

Plat: A map or plan of a certain parcel of land.

Plat Book: A book showing the lots and legal subdivisions of an area.

Plate: A horizontal board placed on a wall or supported on posts or studs to carry the trusses of a roof or rafters directly; a shoe, or base member as of a partition or other frame; a small flat board placed on or in a wall to support girders, rafters, etc.

Pledge: The depositing of personal property by a debtor with a creditor as security for a debt or engagement.

Pledge Agreement: The contract under which a pledge is given as security to a creditor.

Pledgee: One who receives a pledge or a security.

Pledgor: One who owns the thing given as a pledge or security.

Plot Plan: Lot dimensions and improvements drawn to scale and in proportion to boundary lines.

Plottage: Also referred to as Assemblage. The act of buying adjoining properties owned by different people and combining them to create a large parcel worth more than the sum of the individual parts.

Pocket Listing: A trade term. An open listing that a real estate salesperson "pockets" or keeps hidden from his/her associates.

Point: See Discount Points.

Police Power: A governmental agency's power to take actions for the "greater good of society" such as eminent domain and the creation of laws and regulations.

Portfolio Lenders: Lenders that underwrite and approve mortgage loans using their own funds.

Possession: The right to "Quiet use and enjoyment of real property," legally accomplished through a lease. Possession is also held by the mortgagor in a loan secured by a mortgage and by a trustor in a loan secured by a trust deed. Possession is also the commonality of a tenancy in common, a joint tenancy and a tenancy in partnership.

Possessory Interest: Right to possess and use property.

Power of Attorney: An instrument authorizing a person to act as the agent of the person granting it.

Power of Sale: A clause in a mortgage whereby, upon default, the mortgagee can cause a sale of the property without taking court action.

Prefabricated House: A house manufactured and sometimes partly assembled before delivery to building site.

Pre-listing: Marketing time prior to a listing being shared on the MLS or to the public.

Prepaid Residential Listing License: A license used in the business of supplying prospective tenants with listings of residential real properties for tenancy by publication or otherwise with the understanding that the prospective tenant is required to pay a fee in advance of, or at the time of delivery of the listings.

Prescription: Obtaining title to property by adverse possession, by occupying it for the period determined by law to bar action for recovery.

Prima Facie: Presumptive on its face; true, valid, or sufficient at first impression.

Primary Mortgage Market: All lenders who supply funds directly to borrowers and carry the risks associated with long-term financing.

Prime Rate: The lowest rate of interest given by banks to their most credit worthy borrowers.

Principal: The person or legal entity who appointed the agent in a transaction.

Principle of Progression: An economic theory based upon the belief that the smallest, oldest, and most rundown home in a neighborhood with much larger, newer, and nicer homes will benefit the most by their higher values. Or, the more expensive homes adjacent to the less expensive home help bring us the property value much quicker.

Principle of Regression: An economic theory where the over-improvement of new construction or a major remodel for a home does not add much higher value (i.e., building the biggest home on the block may be negatively impacted by smaller and more affordable homes nearby) since the smaller homes sales prices are averse to the larger home.

Privity: A mutual relationship to the same rights of property. A relationship between two or more contracting parties. A bond or union of interest.

Procuring Cause: A phrase that is used to describe the agent in an open listing who eventually produces a buyer ready willing and able to purchase under its terms. This is used only with open listings; if an exclusive right to sell listing is given, the broker automatically is the procuring cause and does not need this protection.

Productivity: The highest and best use is that use which is most likely to produce the greatest net return over a given period of time. Productivity is understood in relation to highest and best use.

Progression : This is the reverse of the principle of regression. It states that property of lesser value will be enhanced by proximity to better properties. For example - A \$150,000 property in a neighborhood of \$250,000 to \$300,000 homes might sell for more than \$150,000 because there are people who will pay a premium to live in a higher priced neighborhood.

Promissory Note: The “IOU” in a mortgage packet which includes the detailed loan terms such as the original principal amount, interest rate, and monthly payments.

Proof of Funds: A letter or statement from a lender showing accounts and balances where the buyer will access their funds.

Proprietary Lease: A lease by a “cooperative apartment” corporation to a tenant shareholder.

Proration Items: When a real property sale closes, certain costs arise that must be paid. These expenses, which are incidental to completing the transfer of title, and which are incurred by both the seller and the buyer, are usually referred to as “closing costs.”

Proration of Taxes: To divide or prorate the taxes equally or proportionately to time of use.

Prospectus: A brochure, presenting for a prospective investor the details of an offering.

Protection Clause: Found in listing agreements, it provides that the agent receives his/her commission if the property is sold after the expiration of the listing term to a person with whom the agent has negotiated during the listing term provided the seller is notified in writing, typically within 3 days. Also known as the safety period.

Public Utility: A corporation that is a private enterprise conducted for profit to its owners. Such corporations are under the supervision of the State Public Utilities Commission.

Puffing: An intentional misrepresentation of fact that would, by a reasonably prudent person, be perceived as an exaggerated statement not to be taken literally.

Purchase and Leaseback: An investment strategy where an investor buys a residential or commercial property from a seller prior to later leasing the property back to the seller as his/her tenant.

Purchase Money Encumbrance: (1) A trust deed or mortgage given by the buyer to the seller as part or all the purchase price of the property. (2) A trust deed or mortgage given to a third party as security for the borrowing of money used to purchase less than five residential units, one of which is to be occupied by the purchaser.

Purlin: A piece of timber laid horizontally to support the common rafters of a roof.

Pyramiding: A practice of using “Peter to pay Paul”, e.g., the taking in of investment money and using the new investment money to pay high interest to the old investors. The old investors, being paid in quarterly high returns, get their friends to invest, providing the new large capital to continue to pay the return to the old investors. Also known as a “Ponzi Scheme.” In its non fraudulent state, it means using the equity that has been accumulated in the acquired property as an “equity loan,” never selling until an ever-increasing pyramid of properties are owned. This only works in a “Sellers’ Market” where properties are constantly increasing in value, thus producing the increasingly high equities to be borrowed against.

Qualified Mortgage: One of the main requirements of borrowers enforced as of January 2014 of qualified financial institutions that allows a maximum debt-to-income ratio of 43%.

Quantity Survey Method: One of the methods used to determine the cost of building a proposed improvement on land or to determine the cost of reproducing an already existing improvement on land.

Quarter Round: A molding that presents a profile of a quarter circle.

Quiet Title: A court action brought to establish title, or remove a cloud on title.

Quitclaim Deed: A deed used to remove clouds on title by relinquishing any right, title or interest that the grantor may have.

R1/R2/R3: Code for different types of property zoning. R1 may refer to single family residential zoning and R3 may refer to a residential zoning allowing apartments. Each Planning and Zoning Department may use different codes.

Radiant Heating: A method of heating, usually consisting of coils or pipes placed in the floor, wall, or ceiling.

Radon: A type of dangerous gas formed from the natural breakdown of uranium in soil, rock and water. Found in all counties of California.

Rafter: One of a series of boards on a roof designed to support roof loads. The rafters of a flat roof are sometimes called roof joists.

Range: A strip of land six miles wide, determined by a government survey, running in a North South direction.

Rate: The percentage amount charged on a personal or mortgage loan such as an interest rate.

Ratification: The adoption or approval of an act performed on behalf of a person without previous authorization.

Ready, Willing, and Able Buyer: A person who is fully qualified and prepared to agree to the terms of a purchase contract. These defined buyers also can determine whether an agent has performed and earned their proposed commission payment.

Real Estate Board: A voluntary nonprofit trade organization whose members are engaged in some phase of the real estate business and consist primarily of licensed real estate brokers and salespersons.

Real Estate Commissioner: Appointed by the Governor and heads the DRE which is part of the California Department of Consumer Affairs.

Real Estate Counselor: A real estate licensee that provides competent, disinterested, and unbiased advice, professional guidance, and sound judgment on diversified problems in the broad field of real estate involving many segments of the business.

Real Estate Investment Trust: A special arrangement under Federal and State law whereby investors may pool funds for investments in real estate and mortgages and yet escape corporation taxes; requires one hundred persons or more.

Real Estate Settlement Procedures Act: See RESPA.

Real Estate Syndicate: A group or pool of large numbers of investors organized as a limited partnership, or as some other formal or legal group, for buying one or more residential or commercial properties.

Real Property: Immovable, fixed property that is not personal property.

REALTOR®: A member of the National Association of REALTORS®. It is a registered trademark and is not only protected by trademark law, it is protected by the Real Estate Code. Anyone using the name without being a member of a local board of REALTORS® is subject to disciplinary action by the Real Estate Commissioner.

Reasonable Value: This is the term used by VA appraisers in determining the loan value of a property being purchased by a veteran.

Receiver: A court-appointed professional in charge of taking care of the affairs or the sale of personal or real property interests in cases such as bankruptcy filings partly to try to pay off the borrower's debts.

Reconveyance (Deed): The transfer of the title of land from one person to the immediately preceding owner. This instrument is commonly used in California when the performance or debt is satisfied under a deed of trust and the trustee conveys the title he/she has held on condition, back to the owner.

Recordation: The filing for public record of notices for the public such as the recordation of an ownership change or foreclosure filing process.

Recurring Costs: The impounded expenses for the ownership of real property such as property taxes and insurance.

Red Flag: An official warning notification for a real property that there may be severe construction damage due to situations like cracked foundations, walls, or roofs related to the older age of the building or linked to recent earthquakes, flooding, or other natural disasters.

Redemption: The buying back of one's property after it has been lost through foreclosure. Payment of delinquent taxes after sale to the State.

Redlining: When lending institutions attempt to limit their liability for loans by restricting their loans on real property only to those neighborhoods where the more affluent credit responsible homeowners are to be found, the practice is called redlining. The name come from of the practice of drawing a red line on a map and not making loans on the side they have determined to be racially or ethnically undesirable.

Reformation: The correction of a mistake in a deed of trust, contract, or some other type of formal document.

Regression: This principle holds that if a neighborhood consists of dissimilar properties, the value of the better properties will be adversely affected by the presence of the properties of lesser value. EXAMPLE - In a neighborhood of \$150,000 to \$180,000 properties, the value of a \$300,000 property tends to regress towards the value of the prices typical of the neighborhood.

Regulation Z: Common name of part of the Truth-in-lending Act that originated with the Consumer Credit Protection Act enacted in 1968 to protect consumers by requiring standardized disclosures about loan terms and costs.

Rehabilitation: Necessary maintenance, or accrued maintenance.

Reinstatement: The action taken by borrowers to cure a default on a loan by paying the past due amounts in full and restoring the loan to current status; also, the period of time allowed borrowers to take such action.

REIT: An acronym for Real Estate Investment Trust. This is a type of investment entity which taxes the pooled investors individually for their gains in properties (i.e., retail shopping centers, office buildings, etc.) held by the REIT.

Release Clause: A clause used in a blanket encumbrance to release one or more parcels from the encumbrance upon the payment of sufficient cash to pay off that portion applicable to the value of the released parcel(s).

Reliction: The increasing size of a property owner's land due to the receding of adjacent bodies of water such as lakes, rivers, or streams.

Relocation Fee: A fee paid by some lenders to distressed homeowners to encourage them to vacate their home and to alleviate possible damage to the home. Paid after the homeowner vacates.

Remainder Estate: An estate which vests title after the termination of the prior estate, such as a life estate.

Rent: The amount paid for the use of space in a building. In residential property, rent is based on the quality and location of the property. In business property, rent is based on the square footage of the space rented at a price per square foot. The amount of rent is determined by comparison appraising, e.g., comparing the space to be rented in an office building to rent per square foot obtained by owners of similar office buildings in the same community.

Rent Control: A local government's regulation for property owners to restrict the rapid increase of rents for tenants who continue to stay in the property during the term of their lease. Santa Monica, California has several rent control regions despite their prime coastal location.

Replacement Cost: Replacing the property being appraised with an equally useful property without using exact materials used in the structure as it stands is the final estimate of the value if all else fails.

Reproduction Cost: This appraisal approach computes the current cost of reproducing the improvements with an added value for the land, arrived at by comparison with other lands. It is rarely used except on new construction where the elements and costs of construction do not need to be depreciated.

Rescission of Contract: The annulling, revocation or repealing of a contract by mutual consent of the parties to the contract or for cause by either party to the contract.

Rescission: The formal cancellation of a contract by one or more associated parties. Once the contract terminates, each party's relationship reverts to the same position they held before the start of the contract.

Reservation: A right reserved by the grantor in conveying property.

Residential Management Professional (RMP): A management designation awarded by the National Association of Residential Property Managers (NARPM).

RESPA: A consumer protection law first passed in 1974. The Real Estate Settlement Procedures Act (RESPA) helps consumers become better shoppers for settlement services and to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services.

Restriction: Conditions or covenants placed in a deed by an owner or subdivider. The term, as used in relation to real property, means that the owner of real property is restricted or prohibited from doing certain things relating to the property or using the property for certain purposes. If the owner does not live up to the deed restrictions, the other owners having the same restrictions may get a court injunction forcing the owner to do so.

Revenue Stamps: Repealed. See Documentary Transfer Tax.

Reverse Mortgage: A type of a hybrid mortgage and insurance contract combination where an older property owner can pull cash from this loan up until their death. The loan will payoff upon the time of the future sale, or death of the named party somewhat akin to a life insurance payoff.

Reversion: The right to future possession or enjoyment by the person or his/her heirs, creating the preceding estate.

Reversionary Interest: A type of interest a person may have in lands or other property upon the termination of the preceding estate.

Ridge: The horizontal line at the junction of the top edges of two sloping roof surfaces. The rafters at both slopes are nailed at the ridge.

Ridge Board: The board placed on edge at the ridge of the roof to support the upper ends of the rafters; also, called roof tree, ridge piece, ridge plate and ridge pole. Highest board in a wood frame house.

Right of Redemption: The period during which the mortgagor has the right to redeem his/her property by paying off the debt, interest, and costs incurred within one year after the foreclosure sale.

Right of Survivorship: Community Property with Right of Survivorship is a way to hold title that enables married couples to pass property to the surviving spouse without having to go through probate.

Right-Of-Way: A privilege operating as an easement upon land, whereby the owner does, by grant or by agreement, give to another the right to pass over his/her land.

Riparian Rights: The right of a land owner whose land borders on a water-course to use and enjoy the water which is adjacent to the stream and in the watershed of the stream.

Riparian Waters: The water contained in the ordinary flow of a river, stream or natural watercourse.

RLA: Residential Listing Agreement.

R-Rating: A system which has been developed by authorities to measure the relative ability of building installation materials to resist cold and/or to retain heat. R9, R15 and R19 are examples of these ratings. The higher the number, the greater the protection.

Rumford Act: This is one of California's main Fair Housing Laws (also referred to as the Fair Employment and Housing Act).

Run with the Land: Rights in real estate that remain with the land, regardless of ownership. When rights run with the land, they are tied to the property and not to the owner, and will move as the land is transferred from one owner to another.

S.R.E.A.: Designates a person who is a member of the Society of Real Estate Appraisers.

Safety Clause: The portion of a listing contract which protects a broker's commission payment even after the expiration of the listing contract term. An example would be a buyer who was brought into the purchase deal by the listing agent (or "procuring cause"). Yet, this same buyer did not make an offer until after the expiration of the listing term.

Sale Leaseback: An arrangement where the seller of a property leases back the property from the buyer. The specifics of the lease (rent and time periods) are made prior to the sale.

Sales Comparison Approach: The estimation of a property's market value used by both appraisers and agents based upon the most recent sale prices of similar sized properties.

Sales Contract: A contract by which buyer and seller agree to terms of a sale. The seller is referred to as the vendor and the buyer as the vendee.

Sandwich Lease: A leasehold interest which lies between the primary lease and the operating lease. Created when the lessee enters a sublease.

Sash: Wood or metal frame containing one or more window panes.

Satisfaction: A term used when a mortgage has been paid off in full by a borrower.

Scarcity: Demand for a commodity is created by its scarcity and it is limited by the financial ability of people to satisfy their desires and needs. The greater the supply of a commodity available, the lower will be its value.

Scribing: Fitting woodwork to an irregular surface.

Seal: An impression made to attest to the signing of an instrument. A notary seal, a corporation seal.

Seasoned Note: A note or loan that has a history of prompt payments.

Second Trust Deed: Also referred to as a junior loan. Normally created by the owner, accepting the loan in place of a larger down payment to accommodate a buyer with a small down payment. In a "hard money" marketplace, a second trust deed should only be given if the owner has a large enough equity in the property to act as sufficient security for the lien.

Secondary Markets: Where primary lenders sell off their individual or packaged pools of hundreds or thousands of funded residential mortgages.

Secret Profit: Unlawful activity by an agent that involves the agent making money above his/her commission that was undisclosed to his/her client.

Section 1031 Exchange: An exchange of two or more pieces of real property wherein there is no capital gain and any profits are deferred into the future when the properties are sold. Often referred to as a “Tax-free” exchange.

Section: A legal description of land size equivalent to 640 acres.

Security Deposit: The financial security paid by a tenant (i.e., first and last month’s deposit) to a landlord as protection in the event of a future default or damaged caused to the property.

Seller’s Agent: A real estate salesperson working exclusively for their seller.

Seller’s Market: A period in the economy when real estate prices are increasing. A favorable position for the seller to negotiate a higher price on a property.

Selling Agent: A real estate salesperson that is representing the buyer.

Separate Property: Property owned by a husband or wife which is not community property; property acquired by either prior to marriage or by gift, will or inheritance, and all the rents, issues and profits thereof.

Service Debt: The amount of the monthly mortgage payment. Also called debt service.

Servicing Loans: Supervising and administering a loan after it has been made. This involves such matters as collecting the payments, keeping accounting records, computing the interest and principal, foreclosure of defaulted loans, and so on.

Servient Tenement: The party that grants the easement for the benefit of the dominant tenement.

Set-Back Ordinance: A law prohibiting the erection of a building or structure between the property boundary and the set back line.

Severalty Ownership: Owned by one person only. Sole ownership.

Shadow Inventory: A mortgaged home that is more than 90 days’ delinquent or in foreclosure but not yet placed for sale publicly.

Shake: A hand split shingle.

Sheathing: Structural covering usually boards, plywood, or wallboards, placed over exterior studding or rafters of a house.

Sheriff’s Deed: The deed provided to a new buyer at a court-ordered property sale such as at a foreclosure or tax auction sale.

Short Form Report: This type of appraisal is generally used by lending institutions. It consists of simple check sheets or spaces to be filled in by the appraiser. It varies from one-to-four pages in length. It utilizes comparable recent sales in the area. It is seldom used for a client who is unfamiliar with the neighborhood.

Short Rate: When an insurance policy is canceled, the rate for the time that it was in force will increase.

Short Sale: When a lender agrees to take a smaller loan payoff to help the borrower sell the distressed and/or delinquent property.

Sill: The lowest part of the frame of a house resting on the foundation and supporting the uprights of the frame (studs). The board or metal forming the lower part of an opening, as a door sill, window sill, etc.

Simple Interest: The percentage amount paid by a borrower as calculated by the principal balance of their loan. Interest payments can be paid monthly or deferred until the loan's final payoff, depending upon the original terms in the financial contract.

Single Agency: An agency relationship that involves a licensee that represents just one side of a real estate transaction.

Single-Family Dwellings: The most common form of real property ownership. Often called a house. A home is usually located in a neighborhood of similar single family dwellings and all have adequate space by having uniform set back building lines on all four sides of the lot.

Sinking Fund: A sum deposited periodically, earning compound interest.

Sinking Fund Method: An appraisal method that contemplates an annual investment of a given amount in a compound interest bearing fund for the number of years of remaining useful life of the building, and provides for a lump sum return of the present value at the end of the economic life.

Site Analysis: A study, by a appraiser, of the area or the place on which anything is, has been, or is to be located to determine the highest and best use to achieve its greatest value.

Situs: Location of real property.

Social Media: Electronic based communication in which users can network to share and create content.

Soil Pipe: Pipe carrying waste out from the house to the main sewer line.

Sole or Sole Plate: A member, usually a 2" x 4" on which wall and partition studs rest.

Special Agency: A specific type of business relationship in which a principal appoints a real estate agent to work on their behalf for a typically short and defined type of transaction.

Special Assessment: Legal charge against real estate by a public authority to pay cost of public improvements by which the property is benefited.

Specific Lien: A lien on a specific piece of property. Usually a trust deed also a mechanic's lien.

Specific Performance: An action at law to compel the performance of a contract according to its terms.

Specific Plan: The planning, zoning, and development plans and demographic projections for a specific community, town, or city region.

Speculative Value: The amount a speculator will pay for a property on which he/she is speculating. Typically, market value.

Sphere of Influence: A salespersons circle of friends and family. Typically, the first source of clients for a new salesperson.

Staging: The term used when an owner or agent provides furniture and other household items for a property's listing to make the place look more presentable.

Stakeholder: A neutral or disinterested party (e.g., an escrow or trustee in a trust deed).

Standard Title Policy: A type of title insurance that protects the owner from defects in title including previous fraudulent transfers, past tax liens, past judgments, past mechanic's liens, or overlooked defects found in public records. Also, known as an Owner's Title Policy.

Standards of Valuation: Detailed guidelines established for appraisers by the Appraisal Institute.

Statute of Frauds: State law which provides that certain contracts must be in writing to be enforceable at law.

Statute of Limitations: Law that defines a period of time limitation for filing certain kinds of legal action.

Statutory Law: Rules formulated into law by legislative action.

Steering: An illegal activity of a property manager or real estate agent showing clients properties in only a select neighborhood which may reflect their client's own race, religious preferences, or other similar backgrounds.

Step-Up Lease: One form of "graduated lease." The amount of the periodic payment increases over the term of the lease.

Stock Cooperative: A corporation formed for the purpose of holding title where the individual shareholders receive a right of exclusive occupancy in a portion of the property held. A subdivision.

Straight Line Depreciation: Definite equal sum set aside annually from income to pay cost of recapturing the cost of the improvements without reference to interest it earns.

Straight Loans: Loans that are paid in one payment at one fixed time.

Straight Line Method: The straight-line method (age-life) assumes the value declines in equal amounts of depreciation each year until it reaches zero. Using this method, a building with an economic life of 50 years would depreciate 1/50th in value each year.

Strawman: A person used to cover for another as in a real estate transaction to avoid disclosure. "The agent used a strawman to make a secret profit on the sale of his/her client's property."

Street Improvement Act of 1911: California law permitting authorities to finance street improvements by issuing bonds.

Street Opening Act of 1903: California law permitting authorities to build new and improve existing streets by securing assessments to property.

Strip Development: Commercial development in which the main thoroughfares of a city are bordered by an almost continuous row or strip of retail stores and allied service establishments; also, any shopping area that consists of a row of stores.

Studs: Vertical structural lumber, normally 2" x 4" x 8' used in framing a building, usually required to be not more than 16 inches from center to center.

Subagent: Appointed by the listing agent with approval by the principal to help find them a buyer.

Subdivision Interest: Any interest in real property which includes lots, parcels, units or undivided interests subject to regulation under the subdivision laws of the State of California.

Subdivision Map Act: This law establishes that the regulation and control of the design and improvement of subdivisions are vested in the legislative bodies of local agencies.

Subject-to Mortgage: When a grantee takes title to real property “subject to mortgage,” he/she is not responsible to the holder of the promissory note for the payment of any portion of the amount due. The most he/she can lose in the event of a foreclosure is his/her equity in the property. The original maker of the note is not released from his/her responsibility to pay off the obligation.

Subject-to transfer: A type of seller financing that includes the buyer taking over an existing loan or loans without lender approval.

Sublease: A lease given by a lessee.

Subordination Clause: Used in a first or senior lien permitting it to be subordinated to a subsequent lien, such as a construction loan. It converts a senior trust deed into a junior trust deed (second, third, etc.).

Subornation: The crime of getting another person to commit a crime. The procurement of the commission of an unlawful act.

Subpoena: A process to cause a witness to appear and give testimony.

Subprime Loans: Loans given to borrowers who have weakened credit histories and a greater risk of default than prime borrowers.

Subprime Mortgage: See Subprime Loans.

Subrogation: The substitution of another person in place of the creditor to whose rights he/she succeeds in relation to the debt. The doctrine is often used when one person agrees to stand surety for the performance of a contract by another person.

Successors Liability: The requirement that a successor or purchaser of a business or stock of goods withhold money to cover the tax liability of the seller to pay sales tax due at the time of sale.

Sum of the Years Digits: A method of accelerated depreciation allowed by the Internal Revenue Service in special circumstances.

Supplemental Property Taxes: A new property tax bill based upon a change of ownership or new construction that reflects the difference between the new assessed value and the prior assessed value.

Supply and Demand: Demand for a commodity is created by its scarcity and it is limited by the financial ability of people to satisfy their desires and needs. The greater the supply of a commodity available, the lower will be its value.

Surety: One who guarantees the performance of another. Guarantor.

Survey: Method of determining the boundaries of a parcel to provide a legal description. A correct survey must contain a definite point of beginning and definite tract or parcel corners, specific length and directions of the sides of the property and the area within the boundaries in accepted units of measure

Syndicate: An organization of investors, usually in the form of a limited partnership, who have joined together to pool capital for the acquisition of real property interests.

Take-Out Commitment (Letter): Agreement by a permanent lender to place a long-term loan upon completion of construction work.

Take-Out Loan: A permanent long-term mortgage loan that pays off a shorter-term bridge, construction, or acquisition loan.

Tax Deed: The deed issued by the county tax collector after a property has been sold at a tax sale auction after typically more than several years of unpaid property taxes.

Tax Sale: A sale of property, usually at auction, for non payment of taxes assessed against it.

Taxation: A forced contribution of wealth to meet the needs for government.

TDS: The Real Estate Transfer Disclosure Statement (TDS) describes the condition of a property and, in the case of a sale, must be given to a prospective buyer as soon as practicable and before transfer of title.

Tenancy: Tenancy denotes “a holding” of something. In a lease “a holding” of the possession of the property. Joint tenancy a joint holding of the title.

Tenancy at Sufferance: A tenancy which arises when a tenant holds over after the termination of a lease without consent.

Tenancy at Will: A tenancy for an indefinite period which may be terminated at the will of either the lessee or the lessor.

Tenancy in Common: A common way to hold title when two or more individuals own a property. They may have unequal interests, different rights of ownership and may will their interest to different parties.

Tenancy in Partnership: The ownership of property by two or more individuals acting as partners of real property.

Tender: An offer of money, usually in satisfaction of a claim or demand.

Tenements: All rights in land which pass with a conveyance of the land.

Tentative Map: The Subdivision Map Act requires subdividers to submit

Termites: Ant-like insects which feed primarily on wood. All work on property to eliminate this kind of infestation is controlled by the Structural Pest Control Board.

Territorial Settlement: Created when the government wants to encourage people to populate frontier areas, increasing the demand for land.

Testator: The main person who creates a will providing for the distribution of their assets after their death.

Testatrix: The woman who creates a will providing for the distribution of their assets after their death.

Third Party: In agency, anyone with whom the agent deals on behalf of and in place of the principal.

Third-Party Originator: A person or business such as a mortgage brokerage firm which prepares and packages a mortgage application for a borrower prospect prior to sending them to a third-party funding lender.

Tier (Township Lines): A strip of land six miles wide, as determined by the U.S. Government Survey, which runs east and west and which is parallel to the base lines used in the survey system.

Time is of the Essence: A clause in a contract contemplating performance by the date specified therein.

Time-Driven Close: A closing strategy that encourages the prospect to act now to receive the best price.

Time-Share Project: A form of subdivision of real property into rights to the recurrent, exclusive use or occupancy of a lot, parcel, unit, or segment of real property, on an annual or some periodic basis for a specified time. Such projects may be either time share estates or time share uses.

Title: The rights of ownership.

Title Company: Insurance written by a title company to protect the property owner against loss if title is imperfect. A search of city, county and federal recorded instruments is made prior to the issuance of the policy.

Title Insurance: A contracted obligation of a third party that agrees to indemnify a party for property or financial loss dealing with the chain of title.

Title Plants: A data base of records of property information including recorded deeds, liens, judgments, tax records, maps, and court records.

Topography: Nature of the surface of land; topography may be level, rolling, mountainous.

Tort: A breach of contract, or other type of wrongful act, which may later lead to a civil suit in a court of law.

Townhouse: A single-family attached dwelling unit with party walls; usually an individual unit in a series of five to ten houses, with common walls between the units and side yards on the end units only. May have one to three stories and all necessary facilities and amenities. Can be a unit in a condominium project, a planned development or an ordinary subdivision. The townhouse is not legally defined in present California law.

Township: In the survey of public lands of the United States, a territorial subdivision six miles long, six miles wide and containing 36 sections, each one mile square, located between two range lines and two township lines.

Toxic Waste: A common problem in buying abandoned gasoline stations is leaking storage tanks. Therefore, before buying such property, due diligence requires a broker or an appraiser to have the owner obtain a "Toxic Waste Report," issued by a company in the business of cleaning up these conditions, to determine the cost of cleaning up the condition allowing the property to become saleable.

Trade Fixture: Personal property affixed to real property for trade, manufacture, business, etc., such as a showcase permanently attached in a store. The fixtures do not “run with the land” (become real property).

TRID: TILA-RESPA Integrated Disclosure (TRID), integrates existing disclosures with new requirements from the Dodd-Frank Act to improve consumer understanding of the mortgage process. The new TRID forms were implemented by CFPB on October 3, 2015.

Trust: Considered the most valuable personal trait a person can have. The opposite of lying. Having absolute confidence in the words said by the person holding such a high degree of character. In legal terms, it is also called fiduciary.

Trust Account: A separate business account set up by a broker for the deposit of funds from their clients.

Trust Deed : An instrument used to transfer legal title in real property wherein legal title is transferred to a trustee, which holds it as security for a loan (debt) between a borrower and lender. The equitable title remains with the borrower. Also known as a mortgage.

Trustee: One who holds bare legal title to a property in trust for another to secure the performance of an obligation.

Trustee Auction Sale: Part of the foreclosure process when the property is sold by the trustee at least 20 days after Notice of Trustee Sale has been recorded. It may be postponed for up to one year.

Trustee’s Deed: The deed issued to a new buyer at a foreclosure auction sale by the third-party trustee handling the sale.

Trustor: The borrower of money secured by a trust deed. One who transfers his/her bare legal title to a trustee to be held as security until he/she has performed his/her obligation to a lender under terms of a note secured by a deed of trust.

Truth-in-Lending Act (TILA): A federal law passed in 1968 designed to protect consumers by requiring standardized disclosures and calculations on credit terms and costs associated with borrowing.

Turn-Key Project (Property): A building term indicating a complete construction job, from groundbreaking to the final turning over of the key after the last structural detail is completed; the implication being that nothing else need be done but turn the key and move in.

Turn-Over: Refers to the turn over of the average inventory of a business within a specified time.

U.S. Department of Housing and Urban Development (HUD): A federal department that administers housing and urban renewal programs founded in 1965.

UCC-1: A financing statement typically filed with the Secretary of State’s office in Sacramento.

Underwriting Approval: Received by the buyer when financing real estate by their lender stating that the buyer meets the lenders requirements to obtain a loan.

Undue Influence: An unfair or fraudulent influence by a fiduciary, or person of confidential powers, over another person such as in an agent and client relationship.

Unearned Increment: An increase in value of real estate due to no effort on the part of the owner.

Uniform Commercial Code: Laws governing all commercial transactions.

Unit Cost-In-Place Method: A method for determining cost or cost of reproducing an improvement.

Unlawful Detainer: The legal eviction action brought by a landlord against a tenant due to unpaid rents or other violations of a lease agreement.

Unruh Civil Rights Act: The anti-discrimination act for California businesses.

Upside-Down Mortgage: A loan amount on a property which far exceeds the current market value (also referred to as an “underwater mortgage”).

Urban Property: City property; densely settled property.

Urban Renewal: A federal program initiated under the National Housing Act of 1954, primarily educational in nature, striving to awaken communities to the necessity of conserving or rehabilitating rundown areas before they become blighted.

Urbanization: The tendency to settle large numbers of people into close-knit cities.

Useful Life: The period in which the improvements to a property can be used for its original intended purpose.

USPAP: Uniform Standards of Professional Practice created by the Appraisals Standards Board of the Appraisal Foundation.

Usury: The charging of very high rates of interest which are much higher than the current prevailing rates that are permitted by law.

VA Loan: A loan guaranteed by the United States Department of Veteran Affairs and issued by qualified lenders to eligible American veterans or their surviving spouses.

Vacancy: An allowance for the percentage of vacant units must be calculated when arriving at the gross operating income.

Valid: Having force or binding force legally sufficient and authorized by law; enforceable.

Valuation: Estimated worth or price. The act of valuing by appraisal.

Variance: A departure from the general rule A. variance from specific zoning.

Vendee: A purchaser, buyer.

Vendor: A seller; one who disposes of a thing in consideration of money.

Verification: Sworn statement before a duly qualified officer as to the correctness of the contents of an instrument.

Vest: To give an immediate fixed right of present or future enjoyment; to pass to a person or to take effect.

Vested: Bestowed upon someone; secured by someone, such as title to property.

Vested Estate: An absolute, unconditional and indefeasible interest; an estate carrying a fixed right of present or future enjoyment.

Vesting: Refers to current ownership and therefore the owner's legal ability to transfer the property to another. The name on the title must match the name of the seller for the transaction to move forward.

Veteran's Exemption: Every qualified veteran who was a resident of California upon entering the service or a resident of the state prior to November 3, 1964 is entitled to an exemption of \$4,000 of the assessed value.

Vicarious Liability: Acts of an agent that make the principal responsible. The acts of an agent, in terms of legal consequences become, in effect, the acts of the principal. The principal, it follows, has liability for the acts of the agent

Void: An agreement or contract which has no legal enforceability.

Voidable: That which is capable of being adjudged void, but is not void unless action is taken to make it so.

Voluntary Lien: Any lien placed on property with the consent of, or as a voluntary act of the owner.

Vrooman Street Act: Permits cities to improve streets and install public sewers. Bonds may be voted upon to cover costs and be retired by a tax levy. Public utilities also may be acquired in this way.

Waive: To relinquish or abandon; to forego a right to enforce or require anything.

Waiver: To voluntarily give up one's rights, interests, or privileges.

Walk-Up: A building of any kind consisting of two or more stories that does not have an elevator.

Warehousing: The practice, used frequently by mortgage banking institutions, of pledging mortgage and/or trust deed notes to a commercial bank for funds to be used to fund new mortgage loans for clients.

Warranty Deed: A deed used to convey real property that contains express warranties of title and quiet possession, and the grantor thus agrees to defend the premises against the lawful claims of third persons. It is commonly used in other states, but not in California, where it has been supplanted by the grant deed. The modern practice of securing title insurance has reduced the importance of warranty deeds.

Waste: The destruction or material alteration of, or injury to premises by a tenant for life or years.

Water Table: Distance from surface of ground to depth at which natural water is found.

Wholesale Lenders: Lenders that work with mortgage bankers and mortgage brokers to fund loans and then sell it on the secondary market within a month or two.

Will: A legal document where an individual can decide who will receive his/her property upon death.

WORM: "Write once, read many". An acronym for an electronic image storage file that does not allow changes to the stored document or record.

Wraparound mortgage: An All-Inclusive Trust Deed (AITD) is a deed of trust that includes the balance due on one or more existing loans plus new funds that are loaned. Also, known as a Wraparound Trust Deed.

Yield: The amount of interest, or percent of return, earned on an investment over one year or another time range.

Zero-Lot Line Home: Typically, residential property in which the structure comes up to or very close to the edge of the property line. Homes are built close to the property line to create more usable space.

Zoning: Act of city or county authorities specifying type of use to which property may be put in specific areas.

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About the Authors



John Lumbleau was a renowned motivational speaker and sales trainer.

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