



KEY POINT REVIEW

Modern Real Estate Practice

Real estate brokerage is the business of bringing people together in a real estate transaction conducted by

- a **real estate broker** who is a person or company licensed to buy, sell, exchange, or lease real property for others for compensation and who may
 - be the agent of buyer, seller, or both, and
 - not be the agent of any party to the transaction,
- or a **real estate salesperson** who conducts brokerage activities on behalf of the broker.

Appraisal is the process of estimating a property's value (typically, market Value) that is based on established methods and an appraiser's professional judgment and is regulated by the following:

- Licensing or certification is required for many federally related transactions.
- Many states require licensing or certification for local transactions.

Property management is conducted by a **property manager**, a person or company hired to maintain and manage property on behalf of its owner whose

- scope of work depends on a **management agreement**, and
- basic responsibility is to protect owner's investment while maximizing the owner's financial return.

Financing is the business of providing the funds that make real estate transactions possible through

- mortgage or deed of trust loans secured by the property, and
- commercial banks, savings associations, mortgage bankers, and mortgage brokerage companies.

Chapter 1: Introduction to the Real Estate Business

Subdivision and development involve splitting a single property into smaller parcels (subdividing) and constructing improvements on the land (development).

Home inspection is a growing area of interest to both purchasers and homeowners, but note the following:

- A state **license** may be required of a home inspector.
- An **inspection report** will show results of a thorough visual survey of a property.

Chapter 1: Introduction to the Real Estate Business

Real estate counseling involves independent advice based on sound professional judgment.

Types of real property include the following:

- **Residential**—single-family and multifamily
- **Commercial**—office space, shopping centers, stores, theaters, hotels, parking facilities
- **Mixed-use**—commercial and residential uses in the same building
- **Industrial**—warehouses, factories, land in industrial districts, power plants
- **Agricultural**—farms, timberland, ranches, orchards
- **Special-purpose**—schools, places of worship, cemeteries, government-held property

The **real estate market** reflects principles of **supply and demand**, influenced by the **uniqueness** and **immobility** of parcels of real estate so that

- when the **supply increases** and demand remains stable, **prices go down**; and
- when **demand increases** and supply remains stable, **prices go up**.

The factors affecting the **supply** of real estate include the following:

- **Labor force** availability
- Construction and material costs
- **Government controls**—environmental restrictions, land use, building codes, zoning
- **Government financial policies** that impact interest rates and the money supply

The factors affecting the demand for real estate include the following:

- **Population**—some areas grow faster than others; some decline
- **Demographics**—family size, lifestyles, niche marketing
- **Employment and wage levels**—influence housing affordability

Land

- is the earth's **surface**, where **water rights** are held by owners of land adjacent to rivers, lakes, or oceans;
- extends downward to the center of the earth, where **subsurface rights** include mineral rights and other natural resources that can be transferred separately from surface rights
- stretches upward to infinity, where **air rights** can be sold separately from surface rights with some limitations to enable air travel; and
- includes things **naturally attached** (*fructus naturales*) to the land, such as trees and crops that do not need cultivation and perennial crops, orchards, and vineyards.

Real estate includes

- land at, above, and below the earth's surface, plus
- all things **permanently attached** to the land, both natural and man-made.

Real property includes

- interests,
- benefits, and
- rights that are automatically included in the ownership of land and real estate.

Bundle of legal rights includes the

- right of possession,
- right to control the property,
- right of enjoyment,
- right of exclusion, and
- right of disposition.

Title is the

- **right to ownership** of the land,
- **bundle of legal rights**, and
- **evidence of ownership** provided by a written document, a **deed**, by which title is transferred.

Chapter 2: Real Property and the Law

Appurtenance is a right or privilege associated with real property in some way, such as a parking space in a multiunit building, an easement, or water rights, and is normally conveyed to the new owner when the property is sold.

Personal property (chattel) includes

- movable items, such as a chair or a sofa
- **emblems** (*fructus industriales*), annual plantings or crops of grains, vegetables, and fruit;
- items of real property that can become personal property by **severance**;
- items of personal property that can become real property by **attachment** (construction materials); and
- **manufactured homes** that can be personal property unless **permanently affixed** to land.

Chapter 2: Real Property and the Law

A **fixture** is personal property that has been affixed to the land or to a building so that by law it becomes part of the real property.

Legal tests for a fixture include the following:

- **Method of annexation**—not easily removable
- **Adaptation to real estate**—ordinarily considered a permanent addition
- **Agreement of the parties**—stated as part of real estate in the offer to purchase

Trade fixtures include property attached to the structure but used in the course of business such as

- **personal property**, if removed by tenant and the premises are returned to original condition before the lease expires; and
- real property if left behind by tenant. The landlord can acquire this type of property by **accession**.

The characteristics of real estate include the following:

- Economic
 - Scarcity
 - Improvements
 - Permanence of investment
 - **Location** (most important)
- Physical
 - Immobility
 - Indestructibility
 - Permanence of investment
 - **Nonhomogeneity**, or uniqueness

Laws that affect real estate include

- contracts, property, agency, and real estate licensing, where all states require real estate brokers and salespeople to be licensed with requirements differing from state to state;
- state and local land-use and zoning laws; and
- federal and state environmental regulations and tax laws.

Types of housing include the following:

- Single-family homes
- Apartment complexes
- Condominiums
- Cooperatives
- Planned unit developments (PUDS)
- Mixed-use developments (MUDS)
- Manufactured housing (mobile homes)
- Timeshares

Housing affordability has been aided by creative financing, low interest loans, adjustable-rate loans, interest-only loans, and low-down-payment loans sponsored by the **Federal Housing Administration (FHA)** and the **Department of Veterans Affairs (VA)**.

The decision to rent or buy is influenced by the following:

- Length of time the individual will reside in the area
- Individual's financial situation
- Housing **affordability**
- Current **mortgage interest rates**
- **Tax consequences** of owning versus renting property
- What may happen to home prices and tax laws in the future

Chapter 3: Concepts of Home Ownership

PITI is an acronym for the following:

- Principal
- Interest
- Taxes
- Insurance

Investment considerations include the following:

- **Appreciation** in the value of the property
- **Equity increase** with an **amortized** loan as the principal is paid
- **Tax deductions**
- **Capital gains taxation exclusion** of \$250,000 or \$500,000 profit on sale of principal residence, if owned and occupied at least two of the past five years
- Penalty-free withdrawals from an **individual retirement account (IRA)** for a down payment on a home within certain limits

A homeowners' insurance policy usually covers the following:

- Fire and lightning, windstorm and hail, and glass breakage
- Explosion, riot, and civil commotion
- Damage by aircraft, vehicles, and smoke
- Vandalism, malicious mischief, and theft
- Loss of property removed from the premises when it is endangered by fire or other perils

The **homeowners' insurance broad-form** policy covers

- falling objects and damage due to weight of ice, snow, or sleet;
- collapse of all or part of the building;
- bursting, cracking, burning, or bulging of steam or water heating system or appliances used to heat water;
- accidental discharge, leakage, or overflow of water or steam from within a plumbing, heating, or air-conditioning system;
- freezing of plumbing, heating, and air-conditioning systems and domestic appliances; and
- damage to electrical appliances, devices, fixtures, and wiring from short circuits or other accidentally generated currents.

A coinsurance clause

- requires the homeowner to maintain insurance equal to at least 80 percent of replacement cost of the dwelling for full replacement on loss; or
- if not, the loss will be settled for actual cash value or a prorated amount.

Chapter 4: Agency

An **agent** is hired by principals to act on their behalf.

Chapter 4: Agency

Agency is the fiduciary relationship in which the agent is held in a position of special trust and confidence by the principal.

Chapter 4: Agency

A **client** is the principal.

Chapter 4: Agency

A **customer** is the nonrepresented party for whom some level of service is provided and who is entitled to fairness and honesty.

A **nonagent** (also known as a facilitator, intermediary, transactional broker, transactional coordinator, or contract broker) assists one or both parties with the transaction without representing either party's interests and often is subject to specific statutory responsibilities.

Real estate agency relationships are governed by **common law**, which is established by tradition and court decisions, and **statutory law**, which is passed by state legislatures and other governing bodies.

Disclosure by real estate brokers of agency relationship is required in every state.

Agency relationships encompass the following:

- **Express agency** is based on a formal agreement between the parties.
- **Implied agency** results from the behavior of the parties.
- The **compensation** source does not determine agency because
 - the agent may be compensated by someone other than agent's client, and
 - agency can exist even if no compensation is involved—**gratuitous agency**.

Chapter 4: Agency

An agent has a fiduciary relationship of trust and confidence with the principal. The six common-law fiduciary duties can be remembered as **COLD AC**, which is an acronym for the following:

1. **Care**—An agent must exercise a reasonable degree of care.
2. **Obedience**—An agent must act in good faith at all times, with obedience toward the principal's instructions.
3. **Loyalty**—An agent must place the principal's interests above those of all others, including the agent's own interests.
4. **Disclosure**—An agent is duty-bound to inform the principal of certain relevant facts concerning the transaction, particularly those mandated by state law.
5. **Accounting**—An agent must be able to report the status of all funds received from or on behalf of the principal.
6. **Confidentiality**—An agent owes the principal confidentiality in carrying out agency obligations.

Termination of agency may be accomplished by the

- completion, performance, or fulfillment of purpose of agency;
- destruction or condemnation of the property
- expiration of the terms of the agency
- mutual agreement of all parties to the contract;
- breach by one of the parties, who may be liable for damages; and
- operation of law, as in the bankruptcy of the principal.

Agency coupled with an interest cannot be revoked by the principal or terminated upon the principal's death.

Chapter 4: Agency

A **universal agent** is empowered to do anything the principal could do personally.

A **general agent** represents the principal in a broad range of matters.

Chapter 4: Agency

A **special agent** (or **limited agent**) represents the principal in one specific act or business transaction only, under detailed instruction.

Chapter 4: Agency

A **designated agent** (or **designated representative**) is authorized by the broker to act as the agent of a specific principal.

Chapter 4: Agency

A **single agency** is one in which an agent represents only one party in a transaction.

Chapter 4: Agency

A **dual agency** (or **limited agency**) is one in which an agent represents two principals in the same transaction.

Chapter 4: Agency

A **buyer's broker** represents a buyer as an agent to find property that meets the buyer's specifications, as set out in the **buyer-broker agreement**.

Statements to clients and customers should be clearly identified as opinion or fact. Note the following distinctions:

- **Puffing** is legal exaggeration of a property's benefits.
- **Fraud** is the intentional misrepresentation of a material fact to harm or take advantage of another person.
- **Negligent misrepresentation** occurs when a broker **should have known** that a statement about a material fact was false.

A seller has the duty to discover and disclose any known **latent** (i.e., hidden) **defects** that threaten a building's structural soundness or an occupant's personal safety. For some agents, the following is important to remember:

- In some states, an agent has an independent duty to conduct a **reasonably competent and diligent inspection** of the property and to disclose defects to prospective buyers.

Stigmatized properties may require an agent to consult an attorney.

Chapter 5: Real Estate Brokerage

All 50 states, Canadian provinces, and the District of Columbia have real estate license laws and rules with the force and effect of law that

- establish basic requirements for obtaining a real estate license,
- may require continuing education for license renewal,
- define which activities require licensing,
- describe acceptable standards of conduct and practice, and
- enforce standards through a disciplinary system.

Chapter 5: Real Estate Brokerage

A real estate broker is licensed to buy, sell, exchange, or lease real property for others for a fee and may operate as a

- sole proprietorship,
- partnership, or
- corporation.

Chapter 5: Real Estate Brokerage

The real estate brokerage may be independent or part of a regional or national franchise.

Chapter 5: Real Estate Brokerage

A real estate salesperson is licensed to perform real estate activities **only** on behalf of a licensed real estate broker.

Chapter 5: Real Estate Brokerage

A broker-employer is liable for the actions of the salesperson
Within the scope of the employment agreement.

An **independent contractor** is a real estate salesperson who

- usually receives a commission, with no withholding for Social Security, income tax, and other purposes;
- has the freedom to set hours and accomplish goals;
- does not relieve the broker of liability for related work activities of the salesperson; and
- must comply with Internal Revenue Service (IRS) requirements for a qualified real estate agent.

An **employee** is a salesperson

- who may receive salary in lieu of or in addition to commission;
- who may receive benefits, such as health insurance, profit-sharing, and workers' compensation;
- whose broker is required to withhold Social Security, income taxes, and other applicable federal and state taxes from earnings of the salesperson;
- whose broker sets hours, duties, and other specifics of day-to-day work; and
- whose broker has liability for related work activities of the salesperson

A real estate assistant is

- a licensed employee of the employing broker, and
- if unlicensed, is limited in the activities that can undertaken.

The Internet is invaluable for communication, research, marketing, and advertising of a brokerage and includes

- e-mail, as a quick and effective way to access most consumers;
- blogs to communicate with other agents and clients;
- vlogs (video blogs), which are becoming increasingly popular and helpful but tend to be expensive to produce;
- multiple listing services (MLSs), which may offer shared Web listings;
- real estate brokerage and real estate salesperson Web pages offering property details;
- Realtor.com, sponsored by the National Association of REALTORS[®], and other popular Web sites to pull in prospective buyers and sellers; and I effective advertising, which must comply with state and federal laws.

Electronic contracting includes

- the **Uniform Electronic Transactions Act (UETA)**, which has been adopted in most states and does not require electronic communication, but if it is used, the
 - contract cannot be denied legal effect just because electronic record was used, and
 - the record or signature cannot be denied legal effect just because it is in electronic format;
- the **Electronic Signatures in Global and National Commerce Act (E-Sign)**, which functions as **electronic transactions** law in states that have not enacted UETA and makes contracts (including signatures) and records legally enforceable, regardless of the medium in which they are created.

Chapter 5: Real Estate Brokerage

Brokers compensation must be agreed upon before agency relationship is established and can be a **commission** based on sales price, flat fee, or hourly rate:

- **Fee for services** is based on charges for separate broker activities that the client desires (unbundling of services)
- Some states now require **minimum services** to be offered by the broker.
- The broker may set a minimum commission rate acceptable for the firm, but any attempt to impose a uniform commission rate would be a violation of state and federal antitrust laws.
- *Entitled* to compensation means that an individual must be
 - a licensed real estate broker;
 - employed by the buyer or the seller under a valid contract; and
 - the **procuring cause** of the sale by starting or causing a chain of events that resulted in the sale.
- The commission is earned when the seller accepts an offer from **ready, willing, and able buyer** prepared to buy on the seller's terms and ready to take positive steps toward consummation of the transaction.

Chapter 5: Real Estate Brokerage

A salesperson's compensation is set by mutual agreement of the employing broker and the salesperson.

Antitrust laws are both state and federal (**Sherman Antitrust Act**) that prohibit

- monopolies; and
- contracts, combinations, and conspiracies that unreasonably restrain trade, including
 - price-fixing;
 - group boycotting;
 - allocation of customers or markets; and
 - tie-in agreements (tying agreements) forcing customers to purchase a product when only another was wanted.

Penalties for antitrust violations include the following:

- Under the Sherman Antitrust Act, violators face up to a \$1 million fine and ten years in prison, with corporate fines as high as \$100 million.
- In a civil suit, the successful plaintiff may recover triple damages plus attorney's fees and costs.

Do-not-call legislation is found at federal and state levels:

- The **National Do Not Call Registry** (regulated by the Federal Trade Commission)
 - lists telephone numbers of consumers who have asked to be registered and
 - prohibits interstate calls to those numbers to sell goods or services.
- Many states provide their own do-not-call legislation for in-state calls.

Chapter 6: Listing Agreements and Buyer Representation

A **listing agreement** is an **employment contract** between a broker and a seller. In all states, the agreement must be in writing to be enforceable in court.

Chapter 6: Listing Agreements and Buyer Representation

As an **agent**, the **broker** is authorized to represent the **principal** and the principal's real estate to consumers. A real estate **salesperson** is a **general agent** of the broker and can carry out listing services only in the name of and under the supervision of the broker.

The characteristics of an **exclusive-right-to-sell listing** include the following:

- **One broker** is appointed as the seller's sole agent.
- If the property is sold while the listing is in effect, the broker is entitled to a commission, no matter who sells the property.

In an **open listing** (also known as a nonexclusive listing),

- the seller retains the right to employ **any** number of brokers;
- the seller is obligated to pay a commission **only** to the broker who successfully produces a **ready, willing, and able buyer**; and
- the seller is not obligated to pay a commission if the seller personally sells the property without the aid of any broker.

Chapter 6: Listing Agreements and Buyer Representation

A multiple-listing clause permits cooperation with other brokers in the multiple listing service (MLS).

A **net listing** has the following characteristics:

- The excess over the net from the sale will go to the listing broker as commission.
- The broker is free to offer the property at any price greater than the net amount.
- Net listings may be prohibited by state law.

A listing agreement may be terminated when

- the agreement's purpose is fulfilled,
- the agreement's term expires,
- the property is destroyed,
- title to the property is transferred by operation of law (e. g., bankruptcy),
- the broker and the seller mutually agree to end the listing,
- either party dies or becomes incapacitated, and
- either the broker or the seller breaches the contract.

Chapter 6: Listing Agreements and Buyer Representation

The **broker protection clause** preserves a brokers commission if, within a certain number of days, the owner transfers the property to someone the broker introduced to them.

Chapter 6: Listing Agreements and Buyer Representation

Disclosures of agency relationships and property condition are important consumer safeguards and may be required by state law.

Government powers can be recalled by using the letters PETE:

- **Police power** is the state's authority—passed down to municipalities and counties through enabling acts
 - to enact nondiscriminatory legislation to
 - preserve order,
 - protect the public health and safety, and
 - promote the general welfare of citizens.
- **Eminent domain** is the government's right to acquire privately owned real estate for a public or economically beneficial use through
 - condemnation, a process that begins with a judicial or an administrative proceeding, or
 - just compensation, which must be paid to the property owner.
- **Taxation** is a charge on real estate to raise funds to meet public needs.
- **Escheat** occurs when the deceased has no will or lawful heirs.

A **freehold estate** lasts for an indeterminable length of time:

- **Fee simple** is the highest estate recognized by law.
- **Fee simple defeasible** is a qualified estate subject to occurrence or nonoccurrence of some specified event.
- Life estate is based on the lifetime of a person.

An **encumbrance** is a claim, charge, or liability that attaches to real estate and may be one of the following:

- **Liens** are charges against property that provide security for a debt or obligation of the property owner.
- **Covenants, conditions, and restrictions (CCSLRS)** are private agreements that affect the use of land.

Easements are rights to use the land of another:

- An **appurtenant easement** is said to **run with the land** when title is transferred.
- An **easement in gross** is an individual or company interest in or right to use another's land.
- An easement is usually created by **written agreement** between the parties.
- An **easement by necessity** arises when land has no access to a street or public way.
- An **easement by prescription** is acquired when a claimant has used another's land for 10 to 21 years. The use must be visible, open, and notorious.

An easement is **terminated**

- when the need no longer exists,
- when the owner of either the dominant or the servient tenement becomes the sole owner,
- when the owner of a servient tenement **releases** the right of easement,
- if the easement is **abandoned**, or
- by the **nonuse** of prescriptive easement.

Chapter 7: Interests In Real Estate

License is a personal privilege to enter the land of another for a specific purpose.

Encroachment occurs when all or part of a structure illegally intrudes on the land of another or beyond legal building lines.

Water rights are determined by common law and statute:

- **Riparian rights** are common-law rights granted to owners of land along rivers, streams, or similar bodies of water.
- **Littoral rights** belong to owners of land that borders commercially navigable lakes, seas, and oceans.
- The **doctrine of prior appropriation** in some states provides that water use, aside from limited domestic use, is controlled by the state rather than the landowner adjacent to the water; to use the water, the landowner must demonstrate **beneficial use** of the water, such as irrigation of crops.

Ownership in severalty, title held by one individual, has the following characteristics:

- Sole rights to ownership
- Sole discretion to transfer part or all ownership rights to another person
- May be a single individual or an artificial person, such as a corporation

Co-ownership, title held by two or more individuals, may be one of four forms:

1. **Tenancy in common**, where
 - each tenant holds an **undivided fractional interest**;
 - co-owners have **unity of possession**—right to occupy entire property;
 - each interest can be sold, conveyed, mortgaged, or transferred; and
 - interest passes by will when a co-owner dies.
2. **Joint tenancy** is where tenants enjoy the four unities (**PITT**):

Co-ownership, title held by two or more individuals, may be one of four forms:

- **Unity of possession**—all joint tenants have undivided right to possession.
- **Unity of interest**—all joint tenants own an equal interest.
- **Unity of time**—all joint tenants acquire their interest at the same time.
- **Unity of title**—title is conveyed to all joint tenants by the same document

Joint tenants also enjoy the right of survivorship; upon the death of a joint tenant, interest passes to the other joint tenant or tenants.

Co-ownership, title held by two or more individuals, may be one of four forms:

Termination of joint tenancy is by

- **death** of all but one joint **tenant**, who then owns the property in severalty;
- **conveyance** of a joint **tenant's** interest, but only as to that interest; or
- **partition**, which can be **brought** to force division or sale of property.

4. **Tenancy by the entirety**, recognized by some states, has the following characteristics:

- Only available to husband **and wife**
- Title conveyed only by **deed signed by both**
- **Carries right of survivorship**; survivor becomes owner in severalty

Co-ownership, title held by two or more individuals, may be one of four forms:

4. **Community property**, recognized by nine states as of 2010, is generally property acquired during marriage that is not separate property.
 - **Separate property** is property owned by one spouse before marriage, or by inheritance or gift or with proceeds of separate property.
 - **Community property** requires the signatures of both spouses to be conveyed.
 - **Separate** property of one spouse requires only that spouse's signature to be conveyed.
 - On the **death** of one spouse, the other spouse owns one-half of community property and other half is distributed according to deceased spouse's will or according to state law.

Chapter 8: Forms of Real Estate Ownership

A **partnership** is an association of two or more persons who carry on a business for profit as co-owners in general or a limited partnership, as provided by state law.

- In a **general partnership**,
 - all partners **participate** in operation and management, and
 - partners share **full liability** for business losses and obligations.
- A **limited partnership** has both general partners and limited partners.
- **General partners** run the business.
- **Limited partners** do not participate in running the business and are liable for business losses only up to the amount of the individuals investment.

A **limited liability company (LLC)** may be permitted by state law and offers its members the following benefits:

- **Limited liability** offered by a corporate form of ownership
- **Tax advantages** of a partnership (no double taxation)
- **Flexible management structure** without corporation requirements or restrictions on limited partnership

Condominium laws of each state define the following:

- The condominium owner holds fee simple title to the airspace of a unit as well as an undivided share in the remainder of the building and land, known as the common elements.
- **Common elements** are owned by condominium unit owners as tenants in common.
- The condominium is administered by a **homeowners' association** of unit owners that may decide to hire an outside property management firm.
- **Maintenance** of common elements is funded by fees charged to each unit owner.
- Unit owners have no right to partition common elements.
- Condominium units may be mortgaged; default on payment does not affect other unit owners.
- The condominium association may have a **right of first refusal** when a unit owner wants to sell.

In a **cooperative**, title to the land and the building is held by a corporation, which sells shares of stock to prospective tenants.

- A purchaser of stock becomes a **shareholder** in the corporation and receives a **proprietary lease** to the apartment for the life of the corporation.
- Stock is owned as personal property and not real estate.
- The **lender** may accept stock as collateral for financing, which expands the pool of potential owners.
- The **IRS** treats a cooperative the same as houses or condominiums for tax purposes.

Chapter 8: Forms of Real Estate Ownership

In a **town house**, a form of ownership in which houses share common vertical walls, titles to individual units include a fractional interest in common areas.

Chapter 8: Forms of Real Estate Ownership

A **time-share** permits the sale of a leasehold interest (time-share use) or deeded ownership (time-share estate) that allows occupancy during a specific period of time, typically weekly.

Chapter 8: Forms of Real Estate Ownership

Time-share ownership permits multiple purchasers to buy interests in real estate, a form of ownership most commonly found with resort property.

Chapter 8: Forms of Real Estate Ownership

The **Model Real Estate Time-Share Act** deals with time-share management and protections for purchasers of units.

The three methods of legal description of land are the following: **The metes-and-bounds method**

- measures distances (**metes**);
- starts from a **point of beginning (POB)**;
- follows compass directions or angles (**bounds**);
- arrives at the **point of ending (POE)**, which must be the same as the POB; and
- uses **monuments** (fixed objects or markers) to identify the PUB and corners or places where boundary lines change direction.

The three methods of legal description of land are the following:
The rectangular survey system (government survey system)

- divides land into **rectangles**;
- is measured from the intersection of **principal meridians** and **base lines**;
- is referenced by degrees of **longitude and latitude**;
- uses **township lines**, which run east to west parallel to and counted from base lines that are
 - **6 miles** apart,
 - in units called **townships** of 36 square miles each,
 - in rows of townships called **tiers**, and
 - arranged so each township is divided into **36 sections** of one mile square (640 acres), counted from northeast and running right to left, then left to right, and so on; and
- uses **range lines**, which run north to south parallel to (and counted from) **principal meridian**, that are
 - **6 miles** apart and
 - in rows **called ranges**.

The three methods of legal description of land are the following: The **lot-and-block (recorded plat) system**

- divides a larger parcel further into **block** (subdivision) and **lot** (individual parcel) numbers and
- references all data in a subdivision **plat map**, noting lot sizes, street names, and other required information that is
 - **approved** by the governing body, and
 - filed in **public records** of the county where the land is located.

Survey preparation includes both a **legal description** and a **survey sketch**. Legal description must be transcribed **exactly** as written to avoid future problems over incorrect boundaries.

Elevations must be measured if **air lots** above the surface or **subsurface rights** are to be described and conveyed, with

- distances noted as above or below datum, defined by U. S. Geological Survey (USGS) as **mean sea level at New York Harbor**, and making use of
 - permanent **benchmarks** often based on a **local official datum**, and
 - **monuments** marking surface measurements between points.

Chapter 9: Legal Descriptions

The most common units of land measurement include the

- **mile** of 5,280 feet
- **acre** of 43,560 square feet (approximately 207 X 207 feet), and
- **square mile** of 640 acres.

A **lien** is a claim of a creditor or taxing authority against the **real property** of a debtor that is used as security to ensure repayment of the debt. Note the following:

- A lien is not an ownership interest in real estate; it is an **encumbrance** that transfers with it (**runs with the land**) and lessens its value or impairs its use because it binds all successive owners until paid and cleared.
- If a debtor **defaults** in payment of debt, a **lienholder** must bring legal action to
 - force the **sale** of the property, or
 - **acquire title.**

Creation of a lien may be **VISE**, an acronym for the following:

- **Voluntary**, if it is created by action of the property owner, such as a mortgage
- **Involutary**, if it is created without the property owner's express permission
- **Statutory**, if it is created by statute
- **Equitable**, if it is created by a court based on the common law

A lien is either of the following:

- **General**—affects all of a debtor's property, both real and personal. General liens include judgments, estate and inheritance taxes, decedent's debts, corporate franchise taxes, and Internal Revenue Service taxes.
- **Specific**—affects only identified property. Specific liens include a vendor's lien, a mechanic's lien, a mortgage lien, a real estate tax lien, and a lien for special assessments and utilities.

Priority of liens determines the order in which claims will be satisfied (paid off):

- Generally, **first to record is first in right**.
- Real estate taxes and special assessments take **priority** over all other liens.
- A **subordination agreement** between **lienholders** can be used to change order of priority.

Real estate taxes include the following:

- **Ad Valorem** taxes, based on value of property taxed, are
 - specific, involuntary, statutory liens; and
 - levied by states, counties, municipalities, school districts, utility districts, parks and recreation districts, and others.
- **Exemptions** may be available for schools, parks, hospitals, or property owned by municipal, state, or federal governments, or religious or charitable organizations.
- **Reductions** in tax may be made for certain homeowners, including low-income homeowners, senior citizens, and veterans, or for property owned by industries, sports franchises, or farmers.
- Property **assessments** (valuations) are conducted by county or township tax **assessors** or appraisers.
 - **Assessed value** is generally based on sales prices of comparable properties. Land value may be assessed separately from building value and improvements, and different valuation methods may be used for different types of property.
 - **Equalization factor** may be applied to correct inequalities in statewide tax assessments.
- **Tax rates** for each taxing body are computed separately (and may be expressed in mills- 1/1,000 of a dollar, or \$0.001). Mills may be shown as dollars per hundred or thousand dollars of assessed value.

Enforcement of tax liens is as follows:

- **Delinquent** taxes can be collected through a **tax sale**.
- Statutory **notice** requirements must be followed before a tax sale.
- The **taxpayer** usually has **equitable right of redemption** any time before a tax sale.
- The **bidder** at a tax sale who bids the lowest **redemption interest rate** receives the certificate of sale.
- The state may allow a **statutory right of redemption** following a tax sale.
- If there are **no bidders** at the tax sale, property may be forfeited to the state.

Levied on property that benefits from public improvements,
special assessments

- always specific and statutory,
- may be voluntary or involuntary, and
- are usually paid in annual installments over a period of years.

A mortgage or deed of trust lien is a voluntary lien given to a lender by a borrower as security for a real estate loan. The lien takes effect when the lender records the documents in the county where the property is located.

- A **first mortgage lien** on a property, when recorded, has **priority** over other liens (except for tax liens); subsequent liens are **junior liens**.

A **mechanic's lien** is a specific, involuntary lien that gives security to persons or companies that perform labor or furnish material to improve real property.

- A mechanic's lien is **filed** when an **owner** has not fully paid for work or the **general contractor** has been compensated but has not paid subcontractors or suppliers of materials.
- In some states, mechanics' liens have priority over previously recorded liens such as mortgages.

A **judgment**, a decree issued by a court, is a general, involuntary, equitable lien on both real and personal property owned by a debtor that must be filed in every county in which the judgment debtor owns property.

- While a lawsuit is pending,
 - **lis pendens** can be filed to give notice of a possible future lien and establish priority of the claimant, and
 - **writ of attachment** can be sought from the court to authorize the sheriff to seize the property that the debtor may attempt to transfer.

Estate and inheritance tax liens are general, statutory, involuntary liens that encumber a deceased person's real and personal property and are normally paid or cleared in probate proceeding.

A **lien for municipal utilities** is a specific, equitable, involuntary lien on the property of the owner who refuses to pay bills for municipal utility services.

A corporation franchise tax lien is a general, statutory, involuntary lien on real and personal property owned by the corporation.

Chapter 10: Real Estate Taxes and Liens

An **IRS tax lien** is a general, statutory, involuntary lien on all real and personal property held by a delinquent taxpayer; it does not supersede previously recorded liens (which is also true of most state income tax liens).

Following are characteristics of a valid contract:

- A **voluntary agreement** based on consent
 - If a mistake, misrepresentation, fraud, undue influence, or duress occurs, it is **voidable** by the injured party.
- The **agreement** or **promise** is based on an **offer** by one party (**offeror**) that is **accepted** by the other (**offeree**).
 - **Mutual assent** or meeting of the minds exists.
 - **Acceptance** and **revocation** must be communicated by offeree to offeror.
 - A **counteroffer** terminates the original offer and initiates a new offer.
- Made by **legally competent parties between** parties of **legal age** who are able to understand the nature or consequences of their actions
 - A contract with a minor is **voidable**.
- Supported by **legal consideration**,
 - something of legal value, which could be *love* and *affection*, and
 - free of **undue influence** or **fraud**
- Concerned with a **legal act**

A contract may be

- **express** or **implied** by conduct of parties;
- required to be **in writing** to be **enforceable** in a court of law;
- **bilateral** (having obligations on both sides) or **unilateral** (a promise by one side that can be accepted or rejected by the other side);
- **executed** (all parties have fulfilled their promises) or **executory** (one or both parties still have an act to perform);
- **void** if one of the essential elements is missing; or
- **voidable**, if it may be **rescinded** or **disaffirmed** by one or both parties.

Contracts may be **discharged** (completed) by the following:

- **Performance**, which completes the contract terms
- **Partial performance**, if agreeable to both parties
- **Substantial performance**, depending on circumstances
- **Impossibility of performance** (required acts cannot be legally accomplished)
- **Assignment** (transfer of rights to **assignee** or **delegation** of duties)
- **Novation** (substitutes a new contract or party for the original)
- **Breach** by one of the parties without legal cause
 - **Liquidated damages clause** may specify the amount the seller will receive if the buyer defaults.
- Failure to enforce contract within **statute of limitations**
- **Mutual agreement** of parties
- **Operation of law**, as when a contract is void from inception
- **Rescission (cancellation)** by one or both parties

Chapter 11: Real Estate Contracts

Real estate contracts may be completed by real estate licensees if preprinted, standard contract forms are used. **Real estate licensees who are not licensed attorneys may not practice law.** Standard forms may include the following:

- **Real estate sales contract**
 - Usually accompanied by an **earnest money deposit** held in **trust** or **escrow account** to avoid commingling with broker's own funds
 - **Contingencies** to the sale (such as mortgage, inspection, and property sale contingencies) that must be stated in the contract
 - May provide for the purchasers right to inspect the property
 - **Disclosures** required by state law that must be made
- **Land contract-contract for deed, bond for title, installment contract, land sales contract, articles of agreement for warranty deed**
- **Escrow agreement** between buyer, seller, and escrow holder

Chapter 12: Transfer of Title

Title is ownership, or the right to ownership, of land and evidence of that ownership.

Voluntary alienation is the voluntary transfer of title to real estate by **gift** or **sale**, using some form of **deed**.

- **Grantor** (person who transfers title) must be of legal age and legally competent to execute (sign) a deed, A deed executed by a **minor** is **voidable**.
 - **Mental impairment** at time of signing deed makes the deed **voidable**.
 - If the grantor has been declared **incompetent by a judge**, the deed is void.
 - All names the grantor has used should be provided.
- **Grantee** must be identifiable with sufficient certainty.
- **Consideration** (payment) of some form must be stated.
- **Granting clause** (words of conveyance) must be used.
- **Habendum clause** must define ownership interest taken by the grantee; it specifies limits on ownership, such as with a time-share.
- **Legal description** of the property conveyed is essential.
- **Exceptions or reservations** of any relevance must be included.
- **Signature of the grantor(s)** must be **acknowledged** by a notary public or other official authorized by the state in which the property is located.
- **Delivery** of the deed **and acceptance** by the grantee are necessary.

Types of deeds include the following:

- **General warranty deed** provides the greatest protection to the grantee and includes
 - **covenant of seisin**—warrants the grantor has the right to convey title;
 - **covenant against encumbrances**—warrants the property is free from liens or encumbrances, unless expressly stated;
 - **covenant of quiet enjoyment**—makes the grantor liable for damages if the grantee's title is found to be inferior;
 - **covenant of further assurance**—the grantor's promise to obtain any other document necessary to convey good title; and
 - **covenant of warranty forever**—the grantor's promise to compensate the grantee if title fails at any future time.

Types of deeds include the following:

- **Special warranty deed** includes the warranties that the grantor received title and that the property was not encumbered during the time the grantor held title, except as otherwise noted.
- **Bargain and sale deed** implies that the grantor holds title and possession of the property, and there are no express warranties against encumbrances.
- **Quitclaim deed** provides the least protection of any deed, carries no covenants or warranties, and conveys only whatever interest the grantor may have when the deed is delivered.
- **Quitclaim deed** provides the least protection of any deed, carries no covenants or warranties, and conveys only whatever interest the grantor may have when the deed is delivered.

Chapter 12: Transfer of Title

Transfer tax stamps may be required to be affixed to deeds and conveyances before being recorded, with the tax rate depending on state, county, and city requirements.

Involuntary alienation (transfer) of title to property is usually by operation of law.

- **Escheat**—property taken by state when deceased has no heirs
- **Eminent domain**—property taken by public or government agency
- **Foreclosure**—property taken by creditor for nonpayment of debt secured by real property
- **Adverse possession**—property seizure occurring when someone who is not the lawful owner takes possession of property for the length of time specified by state law and usually in a way that is **Open, Notorious, Continuous, Hostile, and Adverse**

Transfer of title by will occurs when the deceased dies **testate** (leaving a will), prepared as required by state law that generally includes the following:

- Wills take effect only after death and can be changed by **codicil** or revoked while the testator is still alive.
- **Devise** is a gift of real property by will to the **devisee**.
- **Bequest** is a gift of personal property.
- **Legacy** is a gift of money.
- To pass title to property on death, the will must be **filed with the court** and **probated**.
- Wills cannot supersede state laws protecting inheritance rights of the surviving wife (**dower**) or husband (**curtesy**).

Chapter 12: Transfer of Title

Transfer of title under a state's **statute of descent and distribution** occurs when a person dies intestate (without a will). **Probate** proceedings must have an administrator appointed, and laws of the state where the real property is **located** govern property distribution.

To serve as **constructive notice**, and with **priority** over subsequent documents, a **written document** is needed that

- affects an **estate, right, title, or interest in land** (such as deeds; mortgages, tax liens, and judgments; and marriage, probate, and other proceedings that may affect title);
- must be **drafted** and **executed** (signed);
- is written according to state law (**recording acts**); and
- is **recorded** in the **public records** that are maintained by the designated **official**, such as the recorder of deeds, county clerk, or city clerk, and held in the **county** (or city) in which the **property is located**.

Chapter 13: Title Records

Public records are typically **searched** by **title companies** that provide **title insurance** to prospective purchasers based on the findings of the title search.

Constructive notice of a document is assumed when **due diligence** (such as a search of public records and inspection of the property) would reveal its existence.

Actual notice means that an individual has **direct knowledge** of documents in the public records and facts revealed by an inspection of the property.

Unrecorded documents that may affect title, such as a tax lien, may not be recorded immediately, yet are still given priority by law and require a search of tax records and other sources.

Chain of title is a record of property ownership, but it does not include liens and other encumbrances:

- A **gap** in the chain or other dispute of ownership creates a **cloud on the title**.
- A cloud on title is resolved by **suit to quiet title**.

Chapter 13: Title Records

An **abstract of title**, prepared by an **abstractor** or an **attorney**, is a **summary** report of what the title search reveals. It includes all **recorded liens** and **encumbrances** and lists **records searched** but does not indicate forgeries and interests that are unrecorded or could be discovered by property inspection.

A **marketable title** is one that must

- **not have serious defects**, nor rely on doubtful questions of law or fact to prove its validity;
- not expose the purchaser to litigation or threaten **quiet enjoyment** of property; and
- convince a reasonably well-informed and prudent purchaser that the property could be sold or mortgaged at a later time.

Proof of ownership may be established by **certificate of title**, but it will not reveal unrecorded liens or rights of parties in possession.

Title insurance, issued as an **owner's policy** or **mortgagee's (lender) policy** under which the insured is protected from losses arising from defects in title, insures against hidden defects and identifies **exclusions** that include readily apparent title defects, zoning, and others.

Chapter 13: Title Records

The **Torrens system**, used in fewer than ten states, provides confirmed certificate of title by the county clerk that requires no further search to validate.

Chapter 14: Real Estate Financing

In a **mortgage**, the **mortgagor** (owner) borrows money from the **mortgagee** (lender), and the real estate is used as **security** for the debt.

Chapter 14: Real Estate Financing

The term **mortgage** refers to any **financing instrument** by which real estate is used as **security** for a debt. The mortgage can take the form of either a **mortgage lien** or a **deed of trust**.

A mortgage lien on property is the common-law form of mortgage with the following characteristics:

- **Lien-theory** states have specific requirements that must be met.
- A **mortgage document** is executed by the borrower and **recorded** in the county in which the property is located.
- When a loan is paid in full, a **defeasance clause** requires the lender to execute a **satisfaction (release or discharge)** that is **recorded** to clear title.
- If the borrower **defaults**, the lender can **accelerate** the due date of the remaining principal balance and all other payments and costs.
- If the borrower continues in default, the lender can bring court action called **judicial foreclosure**

A mortgage lien on property is the common-law form of mortgage with the following characteristics:

- If the borrower continues in default, the lender can bring court action called judicial foreclosure where
 - the **judge** orders the property sold;
 - the **public sale** is advertised and the real estate is sold to the **highest bidder**;
 - the borrower has **equitable right of redemption** within a time period (before and/or after sale) allowed by state law;
 - no court action is necessary to begin the sale process if the mortgage or deed of trust has a **power-of-sale** clause;
 - the mortgagee may have the right to a **deficiency judgment** against the borrower for an unpaid balance, **when allowed by state law**, if the sale proceeds are less than the amount owed;
 - the court can **award title** to the **lender** and no sale occurs if it is a **strict foreclosure**; and
 - the lender may accept a **deed in lieu of foreclosure** from a defaulting borrower, but title is **subject to junior liens** that are eliminated in a foreclosure.

Chapter 14: Real Estate Financing

A deed of trust transfers title from the trustor (property owner) to a trustee, who holds it on behalf of a beneficiary (lender). Note the following:

- **Title-theory** states have specific requirements that must be met.
- A **deed of trust** executed by the borrower is **recorded** in the county in which property is located.
- The **mortgagor** transfers **legal title** to the **mortgagee** but retains **equitable title** and has the right to **possession and use** of the mortgaged property.
- When the loan is paid in full, a **defeasance clause** requires the beneficiary to request the **trustee** to execute and deliver to the trustor a **release deed (deed of reconveyance)** to return legal title to the trustor.
- If the borrower **defaults**, the lender can **accelerate** the due date of the remaining principal balance and all overdue costs.
- If the borrower continues in default, a **deed of trust with power of sale** allows the beneficiary (lender) to ask the trustee to conduct the **trustee's sale** without court action.

Chapter 14: Real Estate Financing

Priority of mortgages and other liens is determined by the order in which they were recorded. Priority may be changed by subordination agreement.

An impound (escrow) account may be required to create a reserve fund to ensure that future tax, property insurance, and other payments are made.

- **Borrower** funds the account through an increase in loan payment that can be remembered as **PITI: Principal, Interest, Taxes, and Insurance**.
- **Lender** makes tax, insurance, and other payments on the **borrower's behalf**.
- The **National Flood Insurance Reform Act of 1994** imposes obligations on lenders and loan servicers to set aside escrow funds for flood insurance on new loans for property in flood-prone areas.

When property with an **outstanding mortgage or deed** of trust is conveyed, the new owner may take title in one of two ways, if allowed by the loan document:

1. **“Subject to”**—the **new owner** makes payments on existing loans but is **not personally liable** if the property is sold on default and proceeds of the sale do not satisfy debt. “Subject to” is no longer in use.
2. **Assuming** the existing mortgage or deed of trust and agreeing to pay the debt, where the **new owner** takes personal responsibility for existing loans and is subject to a **deficiency judgment** if the property is sold on default and proceeds of the sale do not satisfy the debt.

An **alienation clause (due-on-sale clause)** in a loan document will prevent future purchasers of the property from assuming the loan.

A **novation** agreement may be used to release the seller from any future liability on loans secured by the real estate.

The **Federal Reserve System (Fed)** consists of 12 federal reserve district banks.

The **primary mortgage market** consists of lenders that originate mortgage loans based on

- **finance charges** collected at loan closing, including
 - loan **origination fees**, and
 - discount points;
- **recurring income**—interest collected during the term of loan, if kept;
- funds generated by **sale of loans** on the **secondary mortgage market**; and
- fees for **loan servicing** for other mortgage lenders or investors who have purchased the loans.

The primary mortgage market lenders include the following:

- **Fiduciary lenders**—thrifts, savings associations, commercial banks-subject to the
 - **Federal Deposit Insurance Corporation (FDIC)**
- **Insurance companies**—generally investing in long-term commercial, industrial, and large multifamily properties
- Credit unions
- Pension funds
- **Endowment funds** of universities, colleges, and other institutions
- **Investment group financing**—joint ventures, syndicates, limited partnerships, and real estate investment trusts (REITs)
- **Mortgage banking companies**
- **Mortgage brokers**

The secondary mortgage market, where loans are bought and sold after being funded, does the following:

- Provides **additional income** to lenders and **frees up funds** to make more loans, with lenders often retaining servicing functions for a fee
- Purchases mortgage loans through agencies, assembles them into packages called pools, and sells them as **shares (securitized)** to investors or other agencies

Fannie Mae (Federal National Mortgage Association) is

- government-owned with privately issued common stock;
- creates **mortgage-backed** securities using pool of mortgages as collateral; and
- deals in conventional, FHA, and VA loans.

Freddie Mac (Federal Home Loan Mortgage Corporation) is

- government-owned, and
- has authority to purchase mortgages, pool them, and use them as security for bonds sold on the open market but does not guarantee payment of mortgages.

Ginnie Mae (Government National Mortgage Association) is entirely a government agency, a division of the Department of Housing and Urban Development (HUD), organized as a corporation but without corporate stock, that

- administers **special-assistance programs**, and
- guarantees **mortgage-backed securities** using FHA and VA loans as collateral.

Following are types of financing:

- **Straight loan (term loan or interest-only loan)**—periodic payments of interest only for the life of the loan, with payment of principal in full at the end of the loan term
- **Balloon payment (partially amortized) loan**—periodic payments of interest and principal are not great enough to pay down entire amount borrowed by end of loan term, resulting in a larger final payment
- **Amortized (fully amortized) loan**—equal periodic payments of interest and principal result in complete payment of amount borrowed over the term of the loan

Following are types of financing:

- **Adjustable-rate mortgage (ARM)**—lower initial rate of interest that may change over the life of the loan based on a specified index, usually tied to US. Treasury securities
- **Growing equity (rapid-payoff) mortgage**—fixed interest rate but payments of principal increased according to an index or schedule so that the loan is paid off more quickly
- **Reverse mortgage**—payments made by the lender to the borrower, at regular intervals (such as monthly), in a lump sum, or as a line of credit to be drawn against, allowing the borrower to remain in the home while receiving income

Conventional loans are the most secure loans. Note the following:

- The **loan-to-value ratio (LTV)** is often lowest for these loans—traditionally 80 percent—meaning the down payment is 20 percent, but the LTV may be as high as 100 percent.
- Conventional loans are **not** government-insured or guaranteed.
- Conventional loans meet all the requirements of the secondary market, set by Fannie Mae and Freddie Mac, for **conforming loans**, including the following:
 - The borrower's **monthly housing expenses**, including PITI, should be no more than 28 percent of total monthly gross income.

Conventional loans are the most secure loans. Note the following:

- The borrower's **total monthly obligations**, including housing costs and other regular monthly payments, must not exceed 36 percent of the total monthly gross income.
- **Nonconforming loans** must be retained in the lender's investment portfolio.
- **Private mortgage insurance (PMI)** may be required for LTVs higher than 80 percent (i.e., down payments of less than 20 percent). Note the following PMI conditions:
 - Federal law requires PMI to automatically terminate if the borrower has accumulated 22 percent equity in the home (based on purchase price) *and* is current on mortgage payments.
 - **Fannie Mae** and **Freddie Mac** have extended the automatic termination option to all loans that are in good standing and have had no additional financing added to the original loan.

FHA-insured loans are backed by the **Federal Housing Administration (FHA)**, which is part of HUD. FHA does not make loans but insures loans made by an FHA-approved lending institution.

Mortgage insurance premium (MIP) has an up-front fee along with monthly installments. The premium can be financed within the loan.

VA-guaranteed loans are backed by the **Department of Veterans Affairs** and are available to eligible veterans and spouses.

The **Farm Service Agency (FSA)**, formerly **Farmers Home Administration**, is part of the Department of Agriculture and has the following programs to help families purchase or operate family farms:

- Rural Housing and Community Development Service (RHCDS)
- **Farm Credit System (Farm Credit)**
- **Farmer Mac (formerly Federal Agricultural Mortgage Corporation)**

Other types of loans include the following:

- A **purchase-money mortgage** is a note and mortgage created at the time of purchase.
- The **package loan** includes all personal property and appliances as well as real estate.
- A **blanket loan** covers more than one parcel or lot, and a partial release clause allows a borrower to pay off part of a loan to remove the liens from one parcel or lot at a time.
- **Wraparound loans** allow the borrower to obtain additional financing, retaining the first loan on the property.

Other types of loans include the following:

- An **open-end loan** secures the current loan to the borrower and future advances made by the lender to the borrower.
- **Construction loans** finance construction of property improvements.
- **Sale-and-leaseback loans** are used to finance large commercial or industrial properties.
- A **buydown** is a payment made at closing to reduce the interest rate on the loan.
- A **home equity loan (home equity line of credit or HELOC)** is junior to the original lien.

The Truth in Lending Act, Regulation Z of the Federal Trade Commission (FTC), requires that when a loan is secured by a residence, lenders inform borrowers of the true cost of obtaining credit, within the following rules:

- The borrower has a three-day right of rescission.
- Advertising is strictly regulated.
- There is a \$10,000 penalty for each day the violation continues.

The **Equal Credit Opportunity Act (ECOA)** prohibits **discrimination** in granting or arranging credit on the basis of race, color, religion, national origin, sex, marital status, age (as long as the applicant is not a minor), or dependence on public assistance.

Computerized loan origination (CLO) allows real estate brokers and salespersons to assist loan applicants in surveying lenders and providing information.

Chapter 15: Real Estate Financing: Practice

Automated underwriting (loan processing) programs include Fannie Mae's Desktop Underwriter and Freddie Mac's Loan Prospector.

Chapter 15: Real Estate Financing: Practice

A credit score may be used as part of a loan application evaluation process.

Chapter 16: Leases

A **lease** is a contract between the **lessor** (the owner of real estate) and the **lessee** that transfers possession and use of the property, lasts for a **specified period**, and is made in return for **consideration** (possession and payment).

Chapter 16: Leases

The **statute of frauds** in most states requires that leases for more than one year be **in writing to be enforceable**.

Chapter 16: Leases

The lessor (**landlord**) has a **reversionary right** to possession of property when a lease expires.

The lessee (**tenant**) has a **leasehold** estate that can be one of the following:

- **Estate for years (tenancy for years)**—continues for a definite period
- **Estate from period to period (periodic tenancy)**—has no specific expiration date, but rent is payable at definite intervals
 - Has continuity because it automatically renews
 - **Month-to-month tenancy**—a common form of residential lease

The lessee (**tenant**) has a **leasehold** estate that can be one of the following:

- **Holdover tenancy**—may be created when a tenant with an estate for years stays on after the lease term expires and the landlord accepts rent payment
- **Estate at will (tenancy at will)**—has no specified initial term, is created by **express agreement** or **operation of law**, and can be **terminated** by the landlord or the tenant at any time on proper notice
- **Estate at sufferance (tenancy at sufferance)**—created when the tenant stays on without the landlord’s consent after termination
 - The landlord’s acceptance of rent creates a **holdover tenancy**.
 - The landlord can treat a tenant as a **trespasser** and begin eviction proceedings and action for damages under state laws.

Chapter 16: Leases

A valid lease requires parties with CLOAC (Capacity to contract, Legal objectives, Offer and Acceptance, and valid Consideration) and includes the following:

- **Description** of leased premises
- Implied **covenant of quiet enjoyment**
- Limitations on tenant's **use** of the property and the term (length) of the lease
- **Security deposit**, which must comply with state law
- Whether **improvements** may be made by the tenant:
 - Fixtures generally become the landlords property.
 - **Federal fair housing law** requires that the landlord allow a tenant with a physical disability to make reasonable modifications.
 - **Americans with Disabilities Act (ADA)** requires that commercial nonresidential property be free of barriers or that reasonable accommodations be provided.

Chapter 16: Leases

A valid lease requires parties with CLOAC (Capacity to contract, Legal objectives, Offer and Acceptance, and valid Consideration) and includes the following:

- **Maintenance** of premises by landlord in compliance with state law
- **Assignment** of lease that relieves tenant of further obligation
- **Sublease** provisions
- **Recording** of lease that may be required by state law
- **Nondisturbance** clause
- **Option** that may give the tenant the **right to renew** the lease, **right to purchase** property, or **right of first refusal** before landlord can sell the property

Chapter 16: Leases

A **gross lease** requires the tenant to pay basic rent and the landlord to pay expenses of ownership.

Chapter 16: Leases

A **net lease** requires the tenant to pay basic rent plus all or most property expenses and the landlord to pay some property expenses.

Chapter 16: Leases

In a **percentage lease**, the tenant pays basic rent plus a percentage of gross sales and may pay property expenses.

Chapter 16: Leases

A **variable lease** allows an increase in rent during the lease period. A **graduated lease** states specific rent increases. An **index lease** allows rent changes (up or down) based on the consumer price index or other indicator.

Chapter 16: Leases

A **ground lease** involves separate ownership of the land and the buildings.

Chapter 16: Leases

An **oil and gas lease** allows exploration for and removal of oil and gas.

Chapter 16: Leases

In a **lease purchase**, part of the rent may be applied to the purchase price.

A **sale-and-leaseback** allows the original owner to use the property while freeing up capital for other business purposes.

The remedies for breach of a lease are governed by state law and include the following:

- The landlord may bring **suit for possession** (actual eviction).
- The tenant may claim **constructive eviction** if the premises are unusable.

Chapter 16: Leases

The **Uniform Residential Landlord and Tenant Act** has been adopted by some states.

The **Fair Housing Amendments Act of 1988** prohibits discrimination on the basis of race, color, religion, national origin, sex, disability, or familial status.

Chapter 17: Property Management

A **property manager**, whether an individual or a company, acts as the **general agent** of the investment property owner and has fiduciary duties to the owner of **care, obedience, accounting, confidentiality, loyalty, and disclosure** in administering the property to accomplish the following:

- Achieve the **objectives** of the owner
- Generate **income** for the owner
- Preserve and increase the property's **value**

Chapter 17: Property Management

Property management functions may require a real estate broker's or property manager's **license**, as provided by state law.

Property managers may undertake **asset management** by helping the owner to decide the

- **type** of real estate in which to invest—residential or commercial,
- **best** property to purchase,
- **financial resources** to fund the purchase, and
- best time to **dispose** of the property.

Chapter 17: Property Management

A **leasing agent** is usually a state-licensed real estate broker working as an **independent contractor** or property manager on a commission basis.

A corporate property manager is usually an **employee** of the corporation.

A **management plan and management agreement** should include the following:

- **Description** of the property
- **Time period** of the agreement
- Method of **termination** of the agreement
- Definition of the **management's responsibilities**, including limitations and restrictions
- Statement of the **owner's purpose**—long-term goals
- **Owner's responsibilities** for management expenses
- Extent of the **manager's authority**

A management plan and management agreement should include the following:

- **Reporting requirements** of the owner and the state
- **Compensation** to the manager
- **Compliance with applicable federal, state, and local laws**
- **Financial reports**
- Periodic **profit and loss statement** providing general financial information as expressed by the following formula:

Net Profit

Gross Receipts - Operating Expenses - Total Mortgage Payment +
Mortgage Loan Principal

- **Budget comparison statement**, comparing actual results with original budget

The building manager **sets rents** that are

- sufficient to cover fixed charges and operating expenses and a **fair return** on the owner's investment,
- in line with the **prevailing rates** in comparable buildings,
- a reflection of the current **vacancy rate** of the property,
- determined at a **monthly rate per unit** for residential property, and
- calculated at a **monthly rate per square foot** for commercial property.

Chapter 17: Property Management

A building manager **selects tenants** within certain parameters, while complying with all applicable federal, state, and local fair housing, antidiscrimination, and equal opportunity laws.

Commercial tenant considerations typically include the following:

- **Suitability** of the building in size, location, and amenities
- **Compatibility** with the building and other tenants
- **Availability** of space for expansion, if necessary

The building manager should establish a firm and consistent **collection plan** for rents. Lease agreements should spell out the

- **time and place** of payment,
- **penalties** for late payment and bounced checks, and
- **cancellation** procedures and **damages** in case of nonpayment.

Chapter 17: Property Management

Building managers maintain **good relations with tenants** with tact and uniformity through good **communication**, fair and consistent **enforcement** of rules, prompt attention to **maintenance and service requests**, and careful **record keeping**, with attention to lease renewal dates.

Chapter 17: Property Management

To find and retain reliable tenants, a building manager must devise an **effective marketing strategy**.

Following are the federal laws affecting property management:

- **Americans with Disabilities Act (ADA)**, which includes
 - **Title I**—applies to **employers** with 15 or more employees and provides for employment of qualified job applicants, regardless of disability, with reasonable accommodations; and
 - **Title III**—prohibits discrimination in **commercial properties and public accommodations** and requires that access to facilities and services be provided when reasonably achievable in existing buildings, with a higher standard for new construction or remodeling

Following are the federal laws affecting property management:

- **Equal Credit Opportunity Act (ECOA)**, which prohibits lenders from denying a loan based on a person's race, color, religion, national origin, sex, marital status, age, and receipt of public assistance; additional protections may be added by state or local laws
- **Fair Housing Act** and amendments, which prohibit discrimination in the sale, rental, or financing of housing based on race, color, religion, national origin, sex, familial status, or disability; additional protected individuals may be added by state or local laws

Risk management includes treatment of risk by deciding whether to **avoid** it, **control** it, **transfer** it, **or retain** it (**ACTOR**) and focuses on tenant security and types of insurance available.

The **environmental concerns** that require attention of the property manager include the following:

- Disposal of **hazardous wastes**
- **Lead-based paint** disclosure for residential property constructed before 1978

Appraisal is an estimate or opinion of **value** based on supportable evidence and appraisal methods, defined by the **Uniform Standards of Appraisal Practice (USPAP)** and set by the Appraisal Foundations Appraisal Standards Board.

Chapter 18: Real Estate Appraisal

An **appraiser** must be state-licensed or certified for an appraisal performed as part of a federally related transaction.

A competitive market analysis (CMA) is a report by a real estate salesperson of market statistics, but it is not an appraisal.

A **broker's price opinion (BPO)** may be used in a non-federally related transaction: home equity lines, refinancing, portfolio management, loss mitigation, and collections.

Value is created by **demand, utility, scarcity, and **transferability** of property (**DUST**). **Market value** is the most probable price that property should bring in a fair sale, but not necessarily the same as price **paid** or **cost** to construct.**

A sales comparison approach (market data approach) makes use of sales of properties comparable (referred to as **comps**) to the property that is the subject of the appraisal by adding or subtracting the value of a feature present or absent in the subject property versus the comparable.

The **cost approach** estimates current **reproduction** or **replacement cost** of constructing building and other property improvements using the square-foot method, the unit-in-place method, the quantity-survey method, or the index method; and

- estimates **accrued depreciation** using the straight-line method (**economic age-life method**), or
- by estimating items of **physical deterioration**, **functional obsolescence**, or **external obsolescence**.

The **income approach** is based on the present value of the right to future income and uses the following five steps:

1. Estimate annual potential **gross income**.
2. Deduct allowance for vacancy and rent loss to find **effective gross income**.
3. Deduct annual operating expenses to find **net operating income (NOI)**.
4. Estimate **rate of return (capitalization rate or cap rate)** for subject by analyzing cap rates of similar properties.
5. Derive estimate of subject's market value by applying cap rate to annual NOI using this formula:
Net operating income + Capitalization rate = Value.

Reconciliation is the process by which the validity and reliability of the results of the approaches to value are weighed objectively to determine the appraiser's final opinion of value.

Land use is controlled and regulated through

- **public restrictions**—planning, zoning, building codes, subdivision plans;
- **private restrictions** imposed by deed; and
- direct ownership of land by federal, state, and local governments.

The **police power** of the state is its authority to create regulations to protect the public health, safety, and welfare. State enabling acts allow the power to enact laws authorized by the state's police power to be passed down to municipalities and other local governing authorities. Such regulations must be

- exercised in a reasonable manner,
- clear and specific,
- nondiscriminatory, and
- applicable to all property in a similar manner.

Land may be taken for public use through the governments **power of eminent domain** or **condemnation**, with the following limits:

- When a taking of property occurs, the Fifth Amendment to the US. Constitution requires that the owner be given just (fair) compensation.
- A property owner may claim compensation under **inverse condemnation** if an adjacent public land use diminishes the value of the owner's property but the property has not been condemned for public use.

A **comprehensive plan (master plan)** created by a local government usually covers land use, housing needs, movement of people and goods, community facilities and utilities, and energy conservation.

Zoning ordinances are local laws implementing the land uses designated in the comprehensive plan and typically cover items such as **permitted uses**, lot sizes, types of structures, building heights, setbacks, style and appearance of structures, density, and protection of natural resources.

Chapter 19: Land-Use Controls and Property Development

Zoning classifies property by uses and types, such as commercial, industrial, residential, agricultural, and **planned unit developments (PUDs)**.

Other ways in which zoning is used include

- **buffer zones** separating residential from nonresidential areas,
- bulk zoning to control density,
- aesthetic zoning to specify certain types of architecture for new buildings, and
- incentive zoning to require certain uses in developments.

Zoning is enforced through the use of **permits**, and an individual case may be considered by a **zoning hearing board (or zoning board of appeals)**, which may decide to

- allow a **nonconforming use** to continue,
- grant a **variance** from a zoning ordinance to permit a prohibited land use to avoid undue hardship, or
- grant a **conditional-use permit (special-use permit)**.

Building codes require permits for new construction and remodeling of or additions to existing construction.

A certificate of occupancy (occupancy permit) is issued upon satisfactory completion of work for which the permit was issued.

Subdivision and land development ordinances may be created by the state or may be made part of a local governments comprehensive plan. These ordinances usually include the following:

- **Subdividers**, who buy undeveloped acreage and divide it into smaller lots for sale to individuals or developers
- **Developers**, who improve the land, construct homes or other buildings, and sell them
- **Plat map (subdivision map)**, which shows geographic boundaries of separate land parcels, usually by showing **blocks** of land divided into individual **lots**

Subdivision and land development ordinances may be created by the state or may be made part of a local governments comprehensive plan. These ordinances usually include the following:

- **Subdivision plan**, which describes subdivision features and compliance with zoning and other laws, including utility easements, and density zoning
- **Private** land-use controls, such as **restrictive covenants (deed restrictions)**, which are placed in deeds to all property owners in a subdivision and cannot impose an illegal covenant or condition and may be enforced by injunction against property owner in violation of covenant or restriction
 - If in conflict with local zoning, the **more restrictive** controls apply.

The **Federal Interstate Land Sales Full Disclosure Act** regulates the interstate sale of unimproved lots in subdivisions of 25 or more lots of less than 20 acres each. The law does not apply to subdivisions sold solely to developers. **State subdivision laws** may also apply to sales within the state of subdivisions located either inside or outside the state.

Equal opportunity in housing is intended to create a marketplace in which all persons of similar financial means have a similar range of housing choices. Equal opportunity laws apply to owners, real estate licensees, apartment management companies, real estate organizations, lending agencies, builders, and developers.

The **Civil Rights Act of 1866**

- guaranteed **equal housing opportunities** to all U.S. citizens,
- was upheld in ***Jones v. Mayer***, 1968, and
- prohibits all racial discrimination with no exceptions.

Chapter 20: Fair Housing and Ethical Practices

Race was defined by the US. Supreme Court to include ancestral and ethnic characteristics, including certain physical, cultural, or linguistic traits that are shared by a group with a common national origin.

The **Federal Fair Housing Act** is Title VIII of the **Civil Rights Act of 1968** and

- prohibits discrimination in housing based on **race, color, religion, or national origin**;
- does not prohibit discrimination based solely on a person's citizenship status; and
- prohibits illegal activities that include **steering, blockbusting, and redlining**.

The **Housing and Community Development Act of 1974** added **sex** to list of protected classes.

The **Fair Housing Amendments Act of 1988**, which added **disability** and **familial status** (families with children) to protected classes,

- prohibits discrimination against individuals because of their association with people in the protected classes; and
- is administered by HUD, which
 - establishes rules and regulations to further clarify the law, and
 - created the **equal housing opportunity poster**.

Chapter 20: Fair Housing and Ethical Practices

The 1995 Fair Housing Amendment repealed facilities and services requirements designed for older persons and prohibited an award of monetary damages against those who reasonably rely in good faith on property designated as housing for older persons as being exempt from familial status provisions of the Fair Housing Act.

Exemptions from the Fair Housing Act (but not the Civil Rights Act of 1866) include

- rentals in **owner-occupied buildings** with no more than four units;
- housing operated by organizations and private clubs that limit occupancy to members; and
- the sale or rental of a **single-family home** when fewer than three homes are owned by an **individual**, discriminatory advertising is not used, and a real estate licensee is not involved in the transaction.

Chapter 20: Fair Housing and Ethical Practices

Housing is **exempt** from familial status protection if it is restricted to persons age **62** or older, or if 80 percent of the units are occupied by persons over age **55**.

The **Equal Credit Opportunity Act** of 1974 prohibits discrimination in lending on the basis of **race, color, religion, national origin, sex, age, marital status, and public assistance.**

Familial status extends fair housing protections to families with children, meaning a family in which one or more individuals under the age of 18 live with either a parent or a guardian, or a woman who is pregnant, including the following:

- Families with children must be considered under the same terms and conditions as anyone else.
- The property cannot be advertised as adults only, and the ads cannot indicate limitation on the number of children accepted.
- Limitations on the number of people permitted to reside in a house or apartment must be based on objective factors such as sanitation or safety.

A **disability** is a physical or mental impairment that substantially limits one or more of an individual's major life activities.

- Persons with AIDS are considered disabled.
- The law **does not** protect individuals who are **current users** of illegal or controlled substances or who have been **convicted** of the illegal manufacture or distribution of a controlled substance. However, the law **does** protect individuals who are participating in addiction recovery programs.
- **Reasonable modifications** to property to make it usable by an individual with a disability must be allowed, but the individual must return the property to its former condition on vacating it.

The **Americans with Disabilities Act (ADA)** prohibits discrimination in employment and public accommodations; access to facilities and services in commercial properties must be provided when **reasonably achievable** in existing buildings, with higher standards for new construction/remodeling. Exempt properties include those covered by federal fair housing laws.

Megan's Law requires that certain sex offenders register their home location. Although licensees are not required to provide this information, they may be required to inform buyers where the information can be obtained.

HUD enforces the Fair Housing Act in the following manner:

- A **complaint** must be brought within **one year** of the alleged act of discrimination.
- Within **100 days** of filing a complaint that is not referred by HUD to a local enforcement agency, HUD dismisses or goes forward with a charge of illegal discrimination.
 - Conciliation is the resolution of a complaint in the 100-day period when a respondent promises to remedy any violation.

HUD enforces the Fair Housing Act in the following manner:

- A complaint may be heard by an administrative law judge (ALJ), whose remedies include the following **penalties**:
 - **Up to \$11,000** for the first offense
 - **\$27,500** for the **second** violation within five years
 - **\$55,000** for further violations within seven years
 - **Injunction** may also be issued.
- **Civil action** may be brought in federal court within **two years** of discriminatory act.

Chapter 20: Fair Housing and Ethical Practices

The attorney general may bring civil action in federal court, and penalties may include a fine not to exceed

- **\$50,000** for the first violation, and
- **\$100,000** for second and subsequent violations.

Chapter 20: Fair Housing and Ethical Practices

Complaints under the Civil Rights Act of 1866 go directly to federal court.

Chapter 20: Fair Housing and Ethical Practices

Real estate licensees must act legally and ethically to ensure equal access to housing.

Asbestos is a mineral composed of fibers that have fireproofing and insulating qualities. Note the following:

- Asbestos is a health hazard when fibers break down and are inhaled.
- Asbestos has been banned for use in insulation since 1978.
- Encapsulation can prevent asbestos fibers from becoming airborne.

Lead can be found in pipes, pipe solder, paints, air, and soil. Note the following:

- **Lead-based paint** is found in many of the housing units built before 1978.
- Lead accumulates in the body and can damage the brain, nervous system, kidneys, and blood.
- The Lead-Based Paint Hazard Reduction Act of 1992 (LBPHRA) requires disclosure of known lead-based paint hazards to potential buyers or renters.
- **Real estate licensees** provide buyers and lessees with “Protect Your Family from Lead in Your Home,” a pamphlet created by EPA, HUD, and the U.S. Consumer Product Safety Commission.

Radon is an odorless, tasteless, **radioactive gas** produced by the natural decay of radioactive substances in the ground and is found throughout the United States. Radon gas may cause lung cancer. Testing for radon in buildings is not a federal requirement.

Formaldehyde, described as a hazardous air pollutant in the Clean Air Act Amendments of 1990, is used for building and household products, such as **urea-formaldehyde foam insulation (UFFI)**, and may cause respiratory problems, eye and skin irritations, and possibly cancer. Since 1985, it has been regulated by HUD for use in wood products.

Chapter 21: Environmental Issues and the Real Estate Transaction

Real estate licensees should check state formaldehyde disclosure requirements, and appraisers should note the presence of formaldehyde.

Carbon monoxide (CO), a colorless, odorless gas that is by-product of fuel burning,

- is produced by furnaces, water heaters, space heaters (including kerosene heaters), fireplaces, and wood stoves;
- may cause carbon monoxide poisoning, which can result in death unless the gas is properly vented; and
- is detectable with available carbon monoxide detectors, which may be required by state law.

Polychlorinated biphenyls (PCBs) may be found in electrical equipment. Note the following:

- PCBs are suspected of causing health problems.
- The manufacture of PCBs has been banned since January 1, 1979.
- The commercial distribution of PCBs has been banned since July 1, 1979.

Chlorofluorocarbons (CFCs), used in refrigerators, aerosol sprays, paints, solvents, and foam applications, are no longer manufactured worldwide, for the most part since 1996, and have been replaced by available environmentally friendly substitutes for home appliances.

Mold is present in the air everywhere and grows in the presence of moisture, oxygen, and a cellulosic (organic) food source. Note the following:

- Some molds can cause serious health problems.
- The **EPA** has guidelines for remediation and/or cleanup of mold and moisture problems in schools and commercial buildings.
- **Real estate licensees** should recommend a **mold inspection** if mold is evident or suspected because of water problems.

Electromagnetic fields (EMFs) are produced by all electrical appliances. High-voltage electrical lines producing EMEs are under investigation for health risks

Groundwater is found under the earth's surface and forms the water table. The Safe Drinking Water Act (SDWA) of 1974 regulates the public drinking water supply. On property transfers, any water source other than a municipal supply should be tested, as should any septic system.

Underground storage tanks (USTs), which contain petroleum products, industrial chemicals, and other substances, are a concern because the leakage may imperil both public and private water sources. Note the following:

- USTs are subject to federal law and state law, which is sometimes stronger than federal law.
- The EPA regulates the federal UST program.
- When a property purchase is being considered, a careful inspection of any property on which USTs are suspected should be conducted.

Waste disposal sites can be owned by municipalities, be part of commercial enterprises, or be found on farms and other rural properties. Note the following:

- A landfill disposal site, whether excavated or making use of previously mined property, is
 - lined to prevent seepage,
 - capped with soil for aesthetic reasons, and
 - vented to release gases created by decomposing waste.

Brownfields legislation encourages development of abandoned properties by shielding innocent developers from liability for toxic wastes that existed at a site prior to purchase.

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) is administered and enforced by the EPA. CERCLA

- established a Superfund to clean up uncontrolled hazardous waste sites;
- identifies potential responsible parties (PRPs);
- established liability as follows:
 - Strict liability where the landowner has no defense to the responsibility for cleanup
 - Joint and several liability in which each of several landowners is responsible for the entire cleanup
 - Retroactive liability where the present owner and previous owners are responsible
- defined when “innocent landowner” immunity applies.

Environmental liability issues for real estate professionals include the following:

- Discovery of environmental hazards that includes
 - questioning the owner,
 - recommending an environmental audit (environmental site assessment), and
 - an **environmental impact statement (EIS)**, as required for federally funded projects and by the state or locality, if required.

Disclosure of environmental hazards—state laws cover disclosure of known material facts regarding property condition.

Chapter 22: Closing the Real Estate Transaction

Closing (settlement and transfer) is the point at which ownership of a property is transferred in exchange for the selling price.

To complete the transaction, the buyer requires the following:

- Title evidence-a current abstract of title with opinion of title from the buyer's attorney or title commitment from the title insurance company
- Seller's deed
- Affidavit of title by the seller and documents showing the removal of prior encumbrances
- Mortgage reduction certificate from the lender, if the buyer is assuming the loan
- Survey and the results of required inspections

To complete the transaction, the buyer requires the following:

- Leases, if tenants reside on the premises
- Certain charges are **prorated**, divided between the buyer and the seller, in one of two ways:
 - Yearly charge is divided by a **360-day year** (banking year), or 12 months of 30 days each.
 - Yearly charge is divided by a **365-day year** (366 days in leap year) to determine the daily charge, the actual number of days in the proration period is determined, and the number of days is multiplied by the daily charge.
- In most states, the charges are prorated as of the date of closing, with the seller being responsible for the date of closing.

Investment in real estate offers **advantages** of

- **leverage**, which is offered by the use of borrowed money;
- above-average rate of return, generally;
- greater control than ownership of securities;
- tax benefits in certain situations;
- **income (cash flow)** production; and I possibility of property **appreciation** (increase in value over time).

Disadvantages of investment in real estate include

- lack of **liquidity** (ready conversion into cash),
- high cost to acquire,
- active management or cost of hiring a professional property manager, and
- high degree of **risk**, although an investor's ability to hold onto property long term tends to reduce risk.

Cash flow of income property, the amount remaining after all ownership expenses have been paid, tends to make it the safest form of real estate investment, but note the following:

- Rent paid by tenants is a major source of property income and depends on the property's location, physical appearance, and available amenities.
- When rent does not cover property expenses, negative cash flow results.

Pyramiding is a method of using the ownership of one property to drive the acquisition of more properties and usually consists of the following types:

- In pyramiding through selling, the investor acquires a property, improves it for resale at a substantially higher price, and then uses the profit from the sale to purchase another property.
- In pyramiding through refinance, the investor uses the refinance proceeds of one property to purchase new properties.

The tax benefits of owning investment real estate depend on current tax law.

- **Capital gain** is the difference between the adjusted cost basis of a property and its net selling price, and it may be taxed at a more favorable rate than a taxpayer's earned income.
- Adjusted cost basis is the investor's acquisition cost, plus the cost of any physical improvements made to the property, and less the amount of any **depreciation** claimed as a tax deduction.
- **Depreciation (cost recovery)** allows an investor to recover the cost of an income-producing asset through tax deductions over the asset's useful life:

The tax benefits of owning investment real estate depend on current tax law.

- Straight-line depreciation divides the cost attributable to the building by the number of years of projected useful life, currently set by federal law at 29.5 years for residential real estate and 39 years for commercial real estate.
- Accelerated cost recovery system (ACRS) allows taxpayers to claim greater deductions in the early years of ownership, reducing the amount that may be deducted in each subsequent year of a property's defined useful life.
- Losses from the sale of a real estate investment may be deductible.
- Tax credits (direct reductions of tax owed) are available for the renovation of older buildings, low-income housing projects, and historic properties.

Exchanges offer investors the opportunity to defer the payment of taxes on profit indefinitely:

- Property may be **exchanged** for other like-kind property.
- Property owner is taxed only on additional capital or property received as part of the exchange (**boot**).
- Tax is **deferred** (not eliminated), with the capital gain taxed on the eventual sale.

Chapter 23: Real Estate Investment

A real estate investment syndicate is a business venture in which participants pool resources to own or develop property, Pooling of funds may involve securities registration under federal and state securities laws.

A real estate investment trust (REIT) does not pay corporate income tax as long as 95 percent of its income is distributed to its shareholders and other conditions are met. Restrictions and regulations on the formation and operation of REITs are complex.

Chapter 23: Real Estate Investment

A real estate mortgage investment conduit (REMIC) has complex qualification, transfer, and liquidation rules; it is notable because of the asset test requirement.