

CONCEPTS OF REAL ESTATE

Real estate includes the definition of land as well as all natural and man-made improvements that are affixed (permanently attached) to the land. In practice, the term “real estate” is used synonymously with the term “realty” and “real property” to describe the land, improvements, rights, and incidents of ownership.

LAND

The basis of all wealth springs from the land. Land is the solid material of the Earth in whatever natural form it may be found. This includes the soil, rocks, and other substances permanently attached by nature (streams, ponds, plants, etc....). As an investment, land has both economic and physical characteristics which give value and enhance desirability. The economic characteristics are based upon scarcity, demand, utility, and transferability. Physical characteristics define land as immovable, permanent and non-homogenous (no two parcels of land are alike). Although land is generally thought to be only the surface of the land; in modern practice, ownership includes the rights to the soil and mineral deposits below the surface, as well as the air space above the land.

CHARACTERISTICS OF LAND/REAL ESTATE

Real estate possesses seven basic characteristics that define its nature and affect its use. These seven characteristics fall into two broader categories-- economic and physical.

ECONOMIC CHARACTERISTICS: The four characteristics of land that affect its value as a product in the marketplace are **scarcity, improvements, permanence of investment, and area preference:**

- **SCARCITY:** Land as we know it is scarce, and its usability is determined by habitability and productiveness. Our planet is made up of, roughly, $\frac{3}{4}$ open water and $\frac{1}{4}$ dry land. While a considerable amount of land remains unused or uninhabited, the supply in a given location, or of a given quality, is generally considered to be finite (limited).
- **IMPROVEMENTS:** This aspect of real estate can explain how land can become valuable in any area on the Earth. Usually, the cost of building an improvement will be very expensive, and today most investors rely on this aspect of investment for real estate profits. However, as one builds improvements on a parcel of land, this can have a reverse effect on the value of a *different* parcel of land.

Helpful Hints: Improvements

The construction of a new shopping center or the selection of a site for a nuclear power plant can dramatically change the value of land in *any* area.

- **PERMANENCE OF INVESTMENT:** Investments can be structured in all areas of real estate. The capital and labor costs to build an improvement represent a large, fixed investment. Returns on these types of investments tend to be long term and relatively stable.

Helpful Hints: Area Preference

Many homes in the 1950s were built in close proximity to city airports. Common issues with locations near an airport are complaints about the noise of arriving and departing aircraft. Property values under the flight paths of the aircraft will have lost value.

- **AREA PREFERENCE:** This preference for location is a major aspect in the appraisal business and is commonly referred to as **situs** (meaning “site”). This economic aspect refers to natural geography as well as people’s preference for a specific area of real estate. Area preference is based on several factors such as convenience, reputation, and history.

PHYSICAL CHARACTERISTICS: The three physical characteristics of land are **immobility, indestructability, and non-homogeneity:**

- **IMMOBILITY:** Land is immovable and stationary, meaning the geographic location is rigidly fixed.
- **INDESTRUCTABILITY:** Land is durable and can potentially last forever.
- Despite natural or man-made changes that vary the land, the basic element will always be there and remains the same.
- **NON-HOMOGENEITY:** Land is unique, individual, and no two parcels are the same. A parcel of land purchased by a buyer could not be switched by the seller for a (seemingly) identical plot of land.

PERSONAL PROPERTY / CHATTELS

All property is classified as either real property or personal property. An important distinction between the two is that personal property is movable, and it includes all property that is not land or improvements. Real property can become personal property through the process of **severance**. Personal property is transferred with a **bill of sale**, whereas real property is transferred by **deed**. Personal property may be **tangible (corporeal) or intangible (incorporeal):**

Helpful Hints: Severance

A tree growing on the land is considered real property. When the tree is cut down and turned into lumber it is now considered personal property. If this lumber is later used to construct a house, then it will once again be considered real property, as it is affixed to the land.

- **TANGIBLE PERSONAL PROPERTY:** Has physical substance (furniture, cars, clothing, jewelry, etc....) and also known as a **chattel**.
- **INTANGIBLE PERSONAL PROPERTY:** No intrinsic value or material being, the value is derived from what it represents (stocks, bonds, checks, promissory notes, etc....).

FIXTURES

A fixture is a **chattel** which has become permanently attached to the real estate.

LAW OF AFFIXATION

(ANNEXATION): Ownership of real property includes everything that is permanently **affixed or annexed** to the land. An item is considered real property when it is permanently attached to the property. When title to real estate is conveyed; it includes all buildings, structures, and fixtures, even though they may not be specifically mentioned in the deed. Unless there is a written agreement to the contrary, all improvements automatically pass with title.

DETERMINING WHAT A FIXTURE IS:

Due to the fact that the distinction between real property and personal property is not always apparent, disagreements can arise as to whether an item should or should not be included in the sale as a fixture. Purchase and sale agreements should contain a list of items, included, or excluded from the sale, as a way to avoid such problems. That list would include such things as; carpeting, shades, venetian blinds, air conditioners, fireplace fixtures, TV antennas, heating appliances, electrical appliances, etc....

LEGAL TEST OF A FIXTURE: While parties can come to an agreement to determine whether an item will stay or may be removed, this is not a legal test of what defines a fixture (such as when a landlord allows the removal of light fixtures, installed by the tenant, which have become part of the real estate). When parties resort to litigation to determine whether a **chattel** has become a fixture, the court will apply these tests:

- **THE INTENTION OF THE PARTIES:** Did the installer intend the item to remain personal property or to become a part of the real estate?
- **THE MANNER OF ATTACHMENT:** How permanently is it attached? Has it become attached in such a way that it has lost its identity, such as brick & mortar? Would removal result in

Helpful Hints: Property Becoming a Fixture

A chandelier, when initially purchased, is personal property. Once it is permanently installed on the dining room ceiling it has become a fixture, and thus, it has become real property.

Helpful Hints:

Fixture Transfer with Title

A buyer and seller enter into a purchase agreement for the sale of the seller's home. Prior to closing, the seller removes a valuable chandelier and replaces it with another fixture. The buyer has a right to claim ownership of the original chandelier unless the purchase agreement specifically excluded it.

Helpful Hints: Intention of Fixture

A tenant who installs a window air conditioner would most likely be expected to remove it when vacating. A person who builds a picket fence around a parcel of land probably intends to make it a part of the property.

substantial damage to the property, such as the removal of a stained-glass window that may result in damage to the building in which it is installed?

Helpful Hints:

Type/Adaptability of the Fixture

A personal heater is used as personal property. An oil heating unit is used as, and is a part of, the real property.

- **THE RELATION OF THE PARTIES:** The relation between the parties may negate the ordinarily presumed intention of the installer. This circumstance may arise in such situations where a when a landlord installs window air conditioning units in each apartment of a building. A prospective buyer would expect these units to remain as part of the real estate as their purpose is to enhance rental income.

- **TYPE/ADAPTABILITY TO THE REAL ESTATE:** Is it being used as real or personal property?

Helpful Hints: Trade Fixtures

A supermarket may remove frozen food freezers and counters upon termination of the lease.

TRADE FIXTURES: Trade fixtures are items of personal property that are necessary to carry on a business and can be removed by the tenant upon termination of the tenancy. Trade fixtures that are not removed within a reasonable amount of time after the premises has been vacated are considered abandoned. These become property of the landlord through **accession**.

TREES AND CROPS

Trees, perennial shrubs, and grasses, which are permanently rooted in the ground, are considered real property, and pass with transfer of title. **Emblements are annual crops that require cultivation and seasonal planting (wheat, corn, vegetables, etc....) and are treated as personal property, even while growing.** A previous tenant who planted the crops has the right to re-enter the property to harvest them.

MANUFACTURED HOUSING

Manufactured housing defines dwellings that are not constructed on the property but are built off-site and then shipped to the location for installation and/or assembly. The other terms used synonymously with manufactured housing include “modular,” “panelized,” and “precut.” When we refer to mobile homes, we refer to personal property as it is not permanently attached (affixed) to the land. In all cases before 1976, the term mobile home was used to describe factory constructed or housing constructed property. Most states have agencies that administer and enforce federal regulations on manufactured housing, and licensees should always be aware and familiar with local laws before attempting to sell manufactured housing.

CONCEPTS OF OWNERSHIP

FEUDAL SYSTEM AND ALLODIAL SYSTEM

Under early English law, absolute ownership of all land was vested in the king or sovereign, with the subjects having only a right to use the land in return for services provided. This was known as the **feudal system** and was abolished in favor of the **allodial system**, which recognizes the right of individuals to own land subject to no proprietary control of the government. The **allodial** system is used in the United States of America.

PROPERTY RIGHTS - TENEMENTS, APPURTENANCES, AND HEREDITAMENTS

Real property is defined as the ownership of the land as well as interest, benefits, and rights which are related to the property. **Tenements** are property rights of a permanent nature which are related to the land and pass with conveyance of the title. These rights may be tangible (building, fixtures) or intangible (an easement over a neighbor's land). **Appurtenances** are rights and privileges that belong to, and pass with, the title of the property (water rights, easements, improvements). **Hereditaments** are property, real and personal, which are conveyed to heirs upon the death of the owner.

BUNDLE OF LEGAL RIGHTS THEORY: The inherent rights of owning land are referred to as **the bundle of legal rights**. According to the bundle of legal rights theory, ownership of real estate is compared to a bundle of sticks (individual yet still tied-together), with each stick representing an individual right. These rights are **possession, control, quiet enjoyment, exclusion, and disposition:**

1. **POSSESSION:** The owner may live on the land, move away, or come and go as they please.
2. **CONTROL:** The owner may control the way in which the land is used. They may build on the land, leave it vacant, farm it, mine it for minerals, or lease it to others.
3. **QUIET ENJOYMENT:** The owner's right to use and enjoy the property without interference from other parties.
4. **EXCLUSION:** The owner has the right to keep others from entering or using the property.
5. **DISPOSITION:** The owner has the right to sell, will, give away, dedicate, or otherwise dispose of the land in any way they choose.

PHYSICAL RIGHTS OF OWNERSHIP OF LAND

Ownership of land includes separately defined groups of physical rights (Figure 1.1). The various rights of the land may be owned and controlled by more than one individual. One

person may own the surface rights, while another individual owns the air rights, and a third owns mineral rights to mine deposits. These groups consist of **surface rights**, **subsurface rights**, **air rights**, and **water rights**.

Helpful Hints: Separate Owners for One Property's Rights

The airspace above a highway could be purchased by a developer who plans to utilize the space for a hotel, retail store, or restaurant.

Helpful Hints: Lateral Support

If the excavation for a building's foundation removes land support from a neighbor's property, then the neighboring owner has a claim due to their right of lateral support.

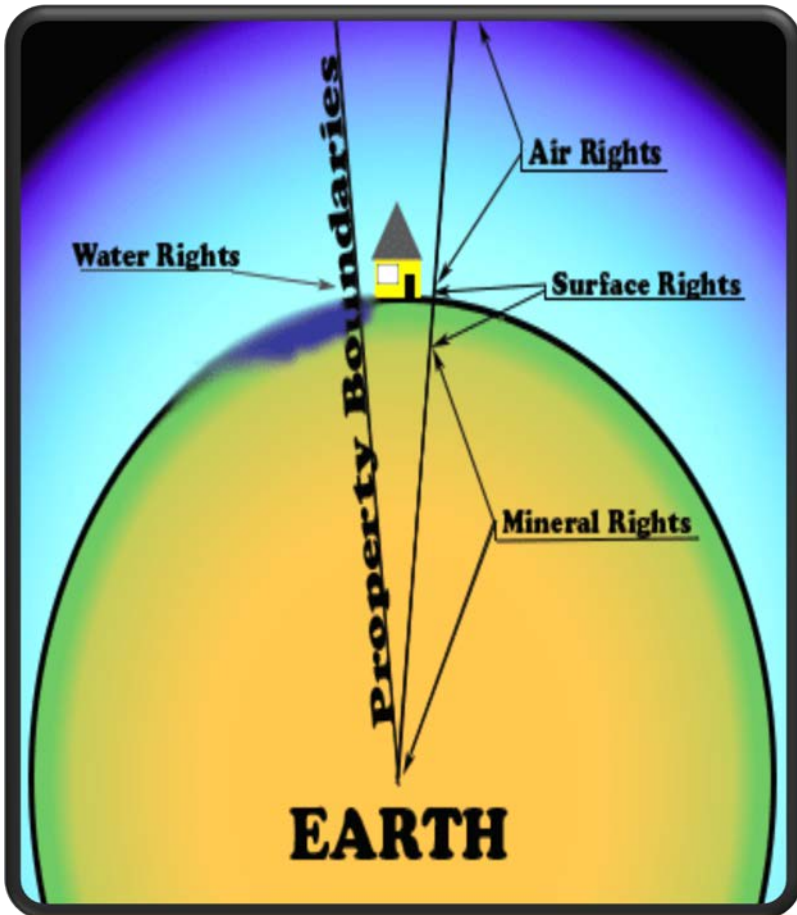
SURFACE RIGHTS: This group refers to the use of the surface of the land. This includes the crust and underlying

soil which provide substance for vegetation and support for structures. This group also includes the **right of lateral support** which ensures that the stability received from an adjacent property will not be removed or destroyed.

SUB-SURFACE RIGHTS: The rights of this group are also referred to as "**mineral rights**." They describe the rights to natural resources below the surface of the

Helpful Hints: Air Rights

An owner would be prohibited from building a patio with a roof that extended over their neighbor's air space. -or- A new, tall building that blocks sunlight from a smaller building may be held accountable for interfering with the small building's right to sunlight—particularly if the smaller building incorporates solar-powered systems.



(Figure 1.1): The physical rights of owning property.

land. Mineral rights pass to the grantee (buyer) with the sale of land unless otherwise specified in the contract. These rights allow an owner to mine for various ores, drill for oil or tap natural gas, as well as entitling them to enjoy any profits that may be produced. Associated with this group of rights is the

law of capture which allows for the siphoning of a natural resource from a deposit which extends beyond the boundary of one's own property.

AIR RIGHTS: This group defines the rights of an owner to use and enjoy the air space above the land to infinity. An owner can lease or sell this space independently, provided the rights have not been preempted by law. Air rights protect an owner from unreasonable obstruction of their property from above. With solar power development today, air rights, and more specifically solar/light rights, are being closely examined by the courts.

WATER RIGHTS: Owners who have property that borders a body of water have **riparian rights** or **littoral rights**:

- **RIPARIAN RIGHTS:** Riparian land is property which borders a natural watercourse such as a lake, stream, or river. Owning property of this nature provides the owner with riparian rights, which exist as a natural and inherent incident of ownership. These generally include the right to use the water for irrigation, swimming, boating, fishing, and for the construction of piers and boathouses.
 - Where the body of water is *navigable*; land rights extend to the water's edge and use of the water must not interfere with public rights.
 - Where the body of water is *non-navigable*; land rights extend to the exact center of the waterway.
- **LITTORAL RIGHTS:** Littoral land is property which exists on the bank or shore of a sea, ocean, or large lake. Owning property of this nature provides the owner with littoral rights. Littoral rights are similar to riparian rights except that they extend only to the mean high-water mark.

LIMITATIONS ON OWNERSHIP

GOVERNMENT POWERS: An individual's right, to use and enjoy a property they own, is limited by certain government powers to protect the common good of the community. These powers include **taxation**, **escheat**, **eminent domain**, and **police power**:

- **TAXATION:** The government has the right to tax property to receive revenue to finance necessary public expenditures (schools, fire stations, hospitals, public employees, etc....).
- **ESCHEAT:** The government has the right to take title to property of a deceased person who dies intestate (without will) and has no heirs. This is to prevent property from becoming ownerless.
- **EMINENT DOMAIN:** The government has the right to take property from an owner, upon just compensation, for public purposes. The procedure for taking property through **eminent domain** is called **condemnation**.
- **POLICE POWER:** The government has the inherent right to restrict the use of the land to preserve order and to protect the public health and safety (rent control, zoning laws, building codes, environmental protection laws, etc....).

PRIVATE OR CONTRACTUAL: Owners may enter into a contract or arrangements which restrict the use of the land or limit their bundle of rights. These limitations include **leases, mortgages, easements, and licenses:**

1. **LEASE:** The owner gives up possession of the property for a temporary time period.
2. **MORTGAGE:** Title to the property is pledged as security for a loan.
3. **EASEMENT:** A right of way given to another to use the land for a specific purpose.
4. **LICENSE:** A privilege to use the land without exclusive control (lease, tenancy-at-will, etc...).

KEYWORDS AND PHRASES

ACCESSION	CAPTURE	FEUDAL SYSTEM	LITTORAL	SEVERANCE
AFFIXATION	CHATTEL	FIXTURES	MANUFACTURED HOUSING	SUBSURFACE RIGHTS
AIR RIGHTS	CONDEMNATION	HEREDITAMENTS	PERENNIAL	SURFACE RIGHTS
ALLODIAL SYSTEM	CORPOREAL	IMPROVEMENTS	PERSONAL PROPERTY	TANGIBLE
ANNEXATION	DISPOSITION	INCORPOREAL	POLICE POWER	TENEMENTS
ANNUAL CROPS	EMBLEMENTS	INTANGIBLE	QUIET ENJOYMENT	TRADE FIXTURES
APPURTENANCES	EMINENT DOMAIN	LAND	REAL PROPERTY	WATER RIGHTS
BUNDLE OF RIGHTS	ESCHEAT	LATERAL SUPPORT	RIPARIAN	

RELATED WEB SITES

CONNECTICUT DEPARTMENT OF CONSUMER PROTECTION:

www.state.ct.us.dcp/

MASSACHUSETTS DIVISION OF REGISTRATION:

www.state.ma/reg/

MAINE OFFICE OF PROFESSIONAL OCCUPATIONAL REGULATION:

www.state.me.us

NEW HAMPSHIRE REAL ESTATE COMISSION:

www.nh.gov/nhrec

EMINENT DOMAIN:

www.realtor.org/topics/eminent-domain-and-private-property-rights

INTEREST IN REAL ESTATE:

topics.law.cornell.edu/wex/real_property/

Multiple Choice Questions

- 1) Items which are considered by law to be permanently attached to the earth are called:
- A. Fixtures.
 - B. Emblements.
 - C. Surface rights.
 - D. Personality.
- 2) Property which is not considered to be a part of the real estate is called:
- A. Personal.
 - B. Fixtures.
 - C. Littoral.
 - D. Appropriated.
- 3) In determining whether an article of personal property has become a fixture; which of the following tests would not be applied?
- A. The manner of attachment.
 - B. The relationship of the parties.
 - C. The adaption to the land.
 - D. The cost of the article.
- 4) All of the following would be considered fixtures EXCEPT:
- A. Stock-designed removable storm windows.
 - B. Built-in kitchen stove.
 - C. Built-in dishwasher.
 - D. Custom fitted wall-to-wall carpeting.
- 5) Which of the following would be considered a part of the real estate?
- A. Perennials planted in a tub.
 - B. House plants.
 - C. Annual crops (corn, wheat).
 - D. Perennial shrubs in the ground.
- 6) Cultivated annual crops are normally classified as:
- A. Personal property.
 - B. Fixtures.
 - C. Real property.
 - D. Fructus.
- 7) Which of the following would not be a part of the real estate?
- A. A birdbath sitting on the lawn.
 - B. A disposal installed by a tenant.
 - C. Perennial shrubs.
 - D. Suspended-tile kitchen ceiling.
- 8) Which of the following is not a physical characteristic of land?
- A. Immobility.
 - B. Non-homogeneity.
 - C. Indestructibility.
 - D. Fungibility.
- 9) The system of private land ownership is known as:
- A. Feudal.
 - B. Allodial.
 - C. Domain.
 - D. Escheat.
- 10) Real property was deeded with no mention of buildings or improvements; would they be included in the conveyance?
- A. Yes, because they are not removable.
 - B. Yes, because they are a part of the land.
 - C. No, because they are personal.
 - D. No, because they were not mentioned in the deed.
- 11) George rented space for a machine shop. He fastened shelves to the wall and bolted machinery to the floor. Are these now the property of the landlord?
- A. Yes, because they are permanent.
 - B. Yes, because their removal will cause damage to the property.
 - C. No, because they are not fixtures.
 - D. No, provided the tenant removes them before the termination of the lease.

12) Prior to showing the property and signing a sales agreement, the seller removed all the bathroom toilets. Is this legal?

- A. Yes, because it was done before the sale.
- B. Yes, because they were personal property.
- C. No, because they were adapted to the property.
- D. No, because they are a part of the realty.

13) Which of the following items is not classified as real estate?

- A. Easement.
- B. Mobile home on a foundation.
- C. Furniture.
- D. Fence.

14) Easements, right-of-way, and condominium parking stalls are examples of:

- A. Emblements.
- B. Trade fixtures.
- C. Riparian rights.
- D. Appurtenances.

15) The government's right to reasonably restrict private use of land is known as:

- A. Eminent domain.
- B. Escheat.
- C. Condemnation.
- D. Police Power.

16) Which of the following is not an example of the exercise of police power?

- A. Rent control.
- B. Building codes.
- C. Zoning laws.
- D. Deed restrictions.

17) A neighbor's tree is overhanging your property. You can legally:

- A. Cut the tree down.
- B. Do nothing about it.

- C. Remove the overhanging branches.
- D. Charge the neighbor damages.

18) Bill moved into a home, before taking title, and installed new kitchen cabinets. The sale fell through and Bill moved out. What is the status of the cabinets?

- A. They are trade fixtures.
- B. Bill may remove them provided he does not damage the property.
- C. Bill cannot get them back.
- D. The cabinets must remain, but Bill is entitled to the value of the cabinets.

19) Since one parcel of land cannot be exactly substituted, it is said to be:

- A. Non-homogeneous.
- B. Immobility.
- C. Fungible.
- D. Mobile.

20) Real property includes:

- A. Leasehold interests.
- B. Fixtures.
- C. Mortgages.
- D. Cultivated annual crops.

21) A landowner who takes water from a river flowing through his or her property is exercising what kind of right?

- A. Littoral.
- B. Prescriptive.
- C. Riparian.
- D. Avulsion.

22) All of the following interests in real estate are considered real property interests EXCEPT:

- A. Water rights.
- B. Fences.
- C. Leases.
- D. Trees.

23) The police power of the state can be used for all of the following EXCEPT:

- A. Controlling land use.
- B. Collecting taxes.
- C. Controlling rents.
- D. Condemning as unfit for occupancy.

24) All of the following are personal property EXCEPT:

- A. Appurtenances.
- B. Chattels.
- C. Trade fixtures.
- D. Mortgages.

25) All of the following are appurtenances EXCEPT:

- A. Trade fixtures.
- B. Water rights.
- C. Mineral rights.
- D. Buildings

26) A property which has littoral rights:

- A. Is subject to restrictive zoning.
- B. Borders a sea or an ocean.
- C. Has ownership restrictions spelled out in the deed.
- D. Includes all mineral, oil, and water rights to the center of the earth.

27) Ownership of land bordering a stream includes certain rights that are known as:

- A. Littoral.
- B. Riparian.
- C. Accretion.
- D. Avulsion.

ESTATES IN LAND

An estate in land is the degree, quantity, nature and extent of interest a person holds in land. Estates in land are classified as either freehold or non-freehold. A person having a freehold estate has title to the land for an indeterminate length of time. Anything less than a freehold is called a non-freehold or leasehold and concerns lessees and tenants.

COMMON LAW VS. STATUTORY LAW: **Common Law** developed from usage and custom over long periods of time. The idea of **Freehold and Non-Freehold** estates developed from common law which grew out of usage over hundreds of years in England and the United States. Common Law may also be modified by individual court decisions known as **Case Law**. **Statutory Law** is enacted by legislation. Common law may be modified or may become the basis for **Statutory Law**.

Helpful Hints: Statutory Law
Derived from Common Law

Almost all statutory laws pertaining to estates in land, transfer of title, mortgages and rights and obligations of landlords and tenants have come directly from common law.

FREEHOLD ESTATES

FEE SIMPLE ABSOLUTE: In most real estate transactions the grantee receives a freehold estate with no limitations or conditions imposed upon the use or enjoyment of the land. This estate is called **Fee Simple Absolute or Fee Simple**, and lasts, for an unlimited duration, potentially forever. A **Fee Simple** is an estate of inheritance. Upon the death of the owner, title passes to his or her legal heirs, unless the property is disposed by will. All deeds or instruments of conveyance automatically convey a fee simple estate unless the instrument contains words to the contrary.

FEE SIMPLE DEFEASIBLE: A **Fee Simple Defeasible Estate** is one that is subject to certain limitations imposed by the grantor. Referred to as a qualified estate, a fee simple defeasible is also an estate of inheritance. Title may be lost upon the happening or no happening of a specified event. There are two kinds of defeasible fees: (1) Fee Simple Subject to a Condition Subsequent and (2) Fee Simple Determinable.

Helpful Hints: Fee Simple Subject to
a Condition Subsequent

Land conveyed, "on the condition that it never is used for a bar," is a fee simple on condition subsequent. The grantor or the grantor's heirs have the option of reclaiming title if the condition is broken.

- **Fee Simple Subject to a Condition Subsequent:** This is a conveyance of title upon the condition that a particular use or activity will not occur. The former owner retains an optional right to regain title if the prohibited activity occurs.
- **Fee Simple Determinable:** This is also called a base fee or fee simple on condition precedent. A fee simple determinable ends automatically if the owner fails to maintain the condition or limitation. Title automatically reverts back to the grantor or to the grantor's heirs. It is created by the use of the words "so long as."

Helpful Hints: Fee Simple Determinable

Property which is granted to a church "so long as" it is used exclusively as the site of a church is a Fee Simple Determinable. If the property is converted to a different use, whether by the original grantee or subsequent owners, title automatically reverts back to the original grantor.

LIFE ESTATE: A non-inheritable, freehold interest in real estate for an unpredictable duration, limited to the life of the grantee (life tenant) or to the life of another (per autre vie). Life Estates are used in cases where the grantor wishes to prevent the grantee from selling the property or using it as collateral for debts.

The grantee may exercise all rights of ownership, but upon the death of the person designated by the grantor the property reverts back to the grantor or to a third person (remainder person). Any conveyance, mortgage or lease executed by the life tenant is nullified at the termination of the life estate.

Upon termination of the Life Estate, the property passes to a remainder person described in the deed or instrument of title. Able deeds property to Baker, "for life, and upon Baker's death, to Able's daughter Ellen." When Baker dies, Ellen, the remainder person, automatically receives title in fee simple.

A Life Estate may also be set up so that when the life tenant dies, title will revert back to the original grantor or to the grantor's estate. This is known as a **Reversionary Life Estate**.

LEGAL LIFE ESTATES - DOWER AND CURTESY, HOMESTEAD

Legal Life Estates were created by common law and statutory law to prevent a deceased property owner's survivor from losing their home to creditors of the deceased or to persons claiming title through actions of the deceased. They consist of dower, curtesy, and homestead.

DOWER and CURTESY: By common law, a married person was given an expectant or contingent one-third life estate in the land held by his or her spouse at any time during their marriage. Dower and Curtesy are inchoate (expectant) rights, which take effect only upon the death of the owning spouse. The wife's right is known as dower, the husband's right, curtesy. The purpose of Dower and Curtesy was to prevent married persons from leaving their spouses penniless at their death. Under common law, the expectant right of Dower and Curtesy could only be terminated by a signed release of the non-owning spouse. Thus, a husband who owned property in severalty could not convey good title unless his wife signed the deed releasing her dower right. If she failed to sign the deed, she would acquire a one-third life estate in the grantee's property when her husband died.

Helpful Hints: Dower and Curtesy

A married couple's home is owned solely by the husband who wills the property to his nephew. When the husband dies, his wife may claim a one third life estate in the property regardless of the terms of the will.

By statute many states, including Massachusetts, have modified the law changing the time when a Dower or Curtesy right is obtained. In these states, the right is acquired only in the real estate owned by the deceased at the time of death. Property transferred by the deceased prior to death is not subject to a claim of Dower or Curtesy, thus eliminating the necessity of requiring the non-owning spouse to sign the deed.

Helpful Hints: Legal Separation vs. Divorce

A wife who owned property in severalty became legally separated from her husband. When she died thirty years later, her husband had a right to a one-third life estate in the property even though she left a will leaving her property to her children.

Divorce terminates Dower and Curtesy rights. A decree of legal separation does not terminate dower and curtesy rights.

Dower and Curtesy rights are very rarely asserted, since the surviving spouse may be entitled to a better interest under the law of descent. By law, a surviving spouse is entitled to one-half of the real estate owned by the deceased spouse at the time of death. Thus, if a man dies leaving a will divesting his wife of all interest in his

real estate, she can ignore the will and claim her rights of descent as though her husband had died intestate.

HOMESTEAD: The Homestead Law allows a portion of a family's home to be protected against claims of creditors. The Massachusetts Homestead Act, M.G.L., Chapter 188, Section 1, allows a homeowner to protect up to \$500,000 of the net market value of a principal residence from the claims of certain creditors. Any homeowner may create a homestead exemption by recording, in the county registry of deeds, a one-page sworn statement declaring a homestead on the property. A homeowner who is sixty-two or over or who is permanently disabled may declare up to \$500,000 in homestead exemption.

The homeowner's creditors may attach the property but may not hold a Sheriff's Sale to satisfy the debt until the homeowner or his or her survivors vacate the residence. When the residence is sold the attaching creditors may assert their claims, subject to the \$500,000 exemption.

Exception to Homestead Exemption: Homestead does not exempt property from claims for taxes, for debts contracted prior to the homestead declaration, for a mortgage to finance the purchase of a home, and for court ordered alimony payments and child support.

Helpful Hints: Homestead

A homeowner, with a \$500,000 homestead exemption, dies, leaving his property to his widow who sells the house for \$525,000. Only \$25,000 is subject to the claims of the deceased's creditors.

NON-FREEHOLD ESTATES

The giving of possession or use of real estate without title creates a **Non-Freehold** or **Leasehold Estate**. Such an interest may either be in writing, in which case it is referred to as a Lease or it may be oral, in which case it is referred to, as a **Tenancy at Will**. In describing leases and tenancies, the words "landlord" and "lessor" have the same meaning, as do the words "tenant" and "lessee". Demise is the conveyance of the use of property by lease. **Leasehold Estates** consist of **tenancy for years**, **periodic tenancy**, **tenancy at will** and **tenancy at sufferance**. **Note:** If an owner of a condominium leases it for one year this type of estate is referred to as a **Leasehold Estate**.

TENANCY FOR YEARS: Created by a written contract (lease) in which the lessor (owner) grants to a lessee (tenant) the right to use a parcel of real estate for a specified period of time, for which the lessee agrees to pay a stipulated rent. The lessee may use and enjoy the leased premises subject to the covenants (conditions) of the lease and must surrender possession to the landlord at the expiration of the lease. A lease can be for any period of time from one day to ninety-nine years.

Helpful Hints: Periodic Tenancy

A landlord and tenant agree to an annual (reserved) rent of \$6,000, which the tenant pays in twelve monthly payments of \$500 each. Even though the rent is paid monthly, either party must give one year's notice to terminate. If it were a tenancy at will, the tenancy could be terminated with one month's notice.

PERIODIC TENANCY (Tenancy from Year to

Year): Continues for an uncertain length of time at an agreed rent which is payable at definite intervals, either monthly or yearly. If the yearly rent is reserved, the tenancy extends from year to year regardless of whether the rent is paid monthly or quarterly. This reservation of rent distinguishes a **Periodic Tenancy** from a **Tenancy at Will**.

TENANCY AT WILL: The transfer of possession by the oral or written consent of the landlord for an

agreed rent, but without agreement for a fixed term. A Tenancy at Will may also be created by operation of law. A Tenancy at Will is established when the landlord accepts rent and gives the tenant a key to an apartment. A Tenancy at Will may be terminated by legal notice from either party. Generally, the notification time must be equal to one rental period. In Massachusetts, a minimum of a **thirty-day notice** is required, regardless of the rental period. A **tenancy at will** is terminated by death of the tenant and by death of the landlord.

TENANCY AT SUFFERANCE: Arises when a tenant, having come into possession of real estate lawfully, remains in possession after the tenancy has been legally terminated. A **Tenant at Sufferance** is liable to the owner for use and occupation of the premises. **Note:** An **Estate of Sufferance** is an estate created when a tenant holds over at the end of a lease term without the landlord's permission. The landlord has the right to recover payment for such use only after the period of use has ended. If payment is accepted in advance, a Tenancy at Will is created. A tenant who remains in possession of an apartment after termination of a lease is known as a **Holdover Tenant** and has the same rights as a Tenant at Sufferance.

LICENSE TO USE REAL ESTATE: A license is a privilege granted to one to use the land of another but without exclusive control or possession. A license to use real estate is a contractual arrangement and not a leasehold interest. Examples include rooming houses, hotel rooms, and a permit to erect a sign on a building or land. Except in Massachusetts, a license to use real estate may be terminated at any time regardless of the oral or written agreement between the parties. Massachusetts requires a thirty-day notice to terminate, if the licensee has been in possession of the premises for a period of three consecutive months or more.

EASEMENTS

An **easement** or **right of way** is a non-possessory right to use the land of another for a specific purpose. An easement is an encumbrance since it burdens the land and diminishes its use and value. While an easement does not prevent transfer of title, failure to disclose the existence of an unrecorded easement may excuse a buyer from performance because of the seller's inability to convey "**good and marketable**" title. Easements do not include title or the right to remove anything from the land.

Note: An "easement" provides legal use, but not ownership.

Easements are categorized as being either **appurtenant** or **in gross**. An appurtenant easement is a type of easement that exists between two parties in which the owner (**dominant tenement**, the property that benefits from the easement) has a parcel of land that in another parcel of land known as the (**servient tenement**, the property that gives the easement). Two parcels of land are necessary for an appurtenant easement. Examples of appurtenant easements are:

- **Appurtenant easements** automatically pass with title to the land. If the owner of lot A has a right of way to cross the adjoining lot B to reach a public road, lot A is the dominant owner and lot B is the servient owner. The transfer of title to either of the lots does not affect the easement.
- **Easement in gross** is a limited right given to a person or business organization to use the land of a servient owner. There is no dominant owner since the right does not benefit another parcel of real estate. An easement in gross terminates with the user's death or discontinuance in the case of a corporation or other business entity. Examples of easements in gross are the rights of way for utilities, such as power, telephone service, cable TV, water, and sewerage. A railroad right of way or the right granted to a person to cross another's land to reach a lake are also examples of easements in gross.

Helpful Hints: Types of appurtenant easements

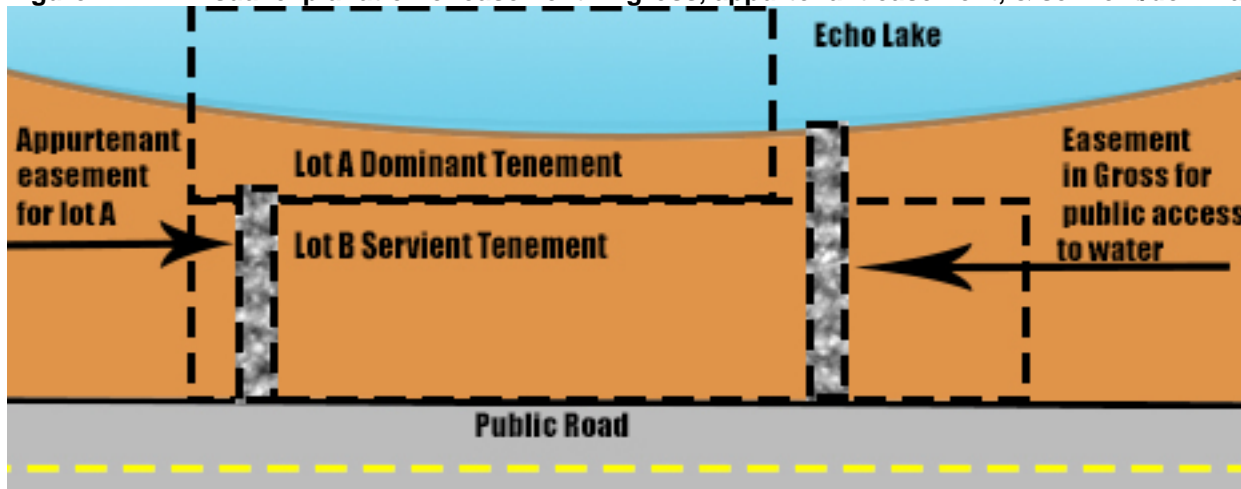
Common driveways, underground pipes, the right to use water from an adjoining parcel of land, and a right of way to cross another's land for access to a public way.

Helpful Hints: Types of Easements in Gross

Rights of way for utilities, such as power, telephone service, cable TV, water, and sewerage. A railroad right of way or the right granted to a person to cross another's land to reach a lake are also examples of easements in gross.

EASEMENT OF LIGHT AND AIR: There is no natural right to have light or air come to a particular part of a person's land. For example, Mr. Brown owns land with a beautiful view of the ocean. The owner of the adjoining lot cannot be barred from building a house, which obstructs Mr. Brown's view even though Mr. Brown has enjoyed the view for over 20 years. Such a right may be acquired, however, by express grant which is clearly stated in a contract, deed, or will, creating an easement for light and air.

Figure 4:1 – A visual explanation of easement-in-gross, appurtenant easement, & servient/dominant tenements



CREATION OF EASEMENTS

Easements may be created by: (1) **Express grant or Reservation**, (2) **Prescription (Adverse Use)** and (3) **Necessity (Implied)**.

1. **Express Grant or Reservation:** A deed may contain a clause granting an easement in favor of the property conveyed or reserving an easement for the benefit of the land retained. Since easements represent an interest in real estate, they must be in writing in order to be enforceable. Thus, if the owner of lot A orally agrees to permit the owner of lot B to use a portion of lot A for a driveway, the agreement will not be binding upon a third person who subsequently buys lot A without actual knowledge of the agreement.
2. **Prescription (Adverse Use):** A prescriptive easement arises when a person adversely uses the land of another over a period of time established by statute. The use must be continuous, open and notorious and in such a manner that the owner of the land has an opportunity to prevent it from occurring. The combining of successive periods of users is known as tacking. By tacking, a person who has not been a continuous user for the entire statutory period may combine his or her use with that of a previous owner to establish a prescriptive easement.
3. **Necessity (Implied):** An easement by necessity will arise by implication of law to prevent a parcel of land from being landlocked. If a property owner sells a portion of a lot and leaves it without access to a street or public way, the law will impose an easement across the seller's remaining land as a means of access. A license to use another's real estate does not create an easement.

TERMINATION OF EASEMENTS: Easements may be terminated by the following events:

- The purpose for which an easement was established ceases to exist.
- Destruction of the servient tenement, as by condemnation for a public use.
- Abandonment or non-use by the owner of the easement.
- Merger of ownership of the dominant and servient tenements.
- Adverse possession or use of the dominant tenement by the servient tenement.

- Release of the dominant tenement to the servient tenement.
- A court decision in a suit to quiet title.
- Excessive use.

PREVENTION OF EASEMENTS BY STATUTORY NOTICE: In many states, a property owner may prevent an easement from being established by posting a notice for six consecutive days or by serving notice to users. A record of this must be recorded within months of its occurrence.

DISCOVERY OF EASEMENTS OR LEGAL DESCRIPTION OF PROPERTY: Not all easements are recorded and therefore will not be discovered through a title search. Only careful inspection of the land or an engineer's survey will reveal easements created by prescription.

Note: In order to verify that a legal description in a deed is accurate a buyer must order a survey. The physical discovery of an unrecorded easement after the execution of a purchase and sale agreement does not automatically permit the buyer to withdraw from the sale unless the seller misrepresented its presence. If there is any doubt regarding the existence of an easement, the broker or salesperson should advise the buyer to have an attorney investigate the matter before concluding the deal.

PARTY WALL: A party wall is located upon or at the division line of two adjoining landowners and is used by both for the construction and support of their respective buildings. If the property line runs to the center of the wall, then each person owns one-half of the wall and has an easement in the other half. Each owner is responsible for maintaining his or her half of the wall for the support of the adjoining buildings. Party walls can be established by use or can be created by grant as in the case of adjoining property owners who agree to share a common wall for the construction of their buildings.

ENCROACHMENTS: An encroachment results from the unlawful intrusion on or over the land of another by a building, structure, or roof overhang. Most encroachments occur by mistake as with the case of a driveway or a fence built without a survey. The encroacher can be ordered to remove the structure and may be subject to paying damages. Encroachments present a problem in selling property, since they are not revealed by a title search. An undisclosed encroachment may render a title unmarketable. A land survey will disclose most encroachments and is usually required by lenders and buyers.

KEYWORDS AND PHRASES

Appurtenant	Easement in Gross	Freehold Estate	License	Periodic Tenancy	Tenancy at Will
Curtesy	Encroachment	Holdover Tenant	Lien	Qualified Estate	Tenancy for Years
Dominant Tenement	Encumbrance	Homestead	Life Estate	Remainder Person	
Dower	Fee Simple Absolute	Implied Easement	Non-Freehold	Reversion	
Easements	Fee Simple Defeasible	Inchoate Right	Party Wall	Servient Tenement	
Easement by Necessity	Fee Simple Determinable	Leasehold Estate	Per Autre Vie	Tenancy at Sufferance	

RELATED WEB SITES:

EMINENT DOMAIN:

WWW.REALTOR.ORG/REALTORORG.NSFPAGES/EMINENTDOMAIN

INTEREST IN REAL ESTATE:

TOPICS.LAW.CORNELL.EDU/WEX/REAL_PROPERTY/

Multiple Choice Questions

1) The greatest estate in land is a:

- A. Fee simple determinable.
- B. Fee simple upon condition.
- C. Life estate in reversion.
- D. Fee simple absolute.

2) The rights of a holder of a life estate are derived from:

- A. The fee simple titleholder.
- B. The laws of inheritance.
- C. A leasehold estate.
- D. Governmental rights in land.

3) Which of the following is not classified as a freehold estate?

- A. An estate created by statute.
- B. A life estate.
- C. A fee simple.
- D. A leasehold estate.

4) Which of the following is an example of a license?

- A. Tenancy at sufferance.
- B. Encroachment.
- C. Theater ticket.
- D. Easement.

5) Marcia had a life estate to which her daughter was named remainder person. Marcia leased the property for five years and died three years later. Her daughter decided to cancel the lease. Which situation is true?

- A. The lease was totally void from the beginning.
- B. The terms of the lease prevailed.
- C. The lease was void upon the death of the life tenant.
- D. The lessee can sue for damages if evicted.

6) The future interest retained by a grantor of a life estate is a:

- A. Remainder interest.
- B. Reversionary interest.
- C. Defeasible interest.
- D. Mortgage.

7) Which of the following is an estate of definite duration?

- A. An estate at sufferance.
- B. A tenancy for years.
- C. A periodic estate.
- D. A tenancy at will.

8) All of the following are legal life estates EXCEPT:

- A. Curtesy.
- B. Dower.
- C. Leasehold.
- D. Homestead.

9) Alex's fence extends two feet onto his neighbor's land. This is a/an:

- A. Easement.
- B. Adverse right.
- C. Encroachment.
- D. Nuisance.

10) Bob owns a parcel of land, which is next to a private school. In his will he leaves the land to the school "so long as it is used for school purposes." When Bob dies the school owns a:

- A. Life estate.
- B. Fee simple absolute.
- C. Leasehold estate.
- D. Fee simple determinable.

11) Gary's neighbor has an easement over Gary's land for access to a lake. Gary's property is called:

- A. The servient tenement.
- B. The dominant tenement.
- C. An adverse right.
- D. Squatter's rights.

12) Property is conveyed to George for life and upon his death to his daughter, Ellen. Ellen has a:

- A. Reversionary interest.
- B. Leasehold.
- C. Fee simple conditional.
- D. Remainder interest.

13) The law which allows a homeowner certain protection from judgments of creditors is known as:

- A. Homestead.
- B. Curtesy.
- C. Dower.
- D. Tacking.

14) The easement of a utility company that prohibits one from building over a gas line would be:

- A. Personal.
- B. Affirmative.
- C. In gross.
- D. Appurtenant.

15) A sale of land would not affect:

- A. Restrictive covenants.
- B. Express easements.
- C. Rights of mechanic's lien holders
- D. Any of the above.

16) An easement may be extinguished by:

- A. Agreement.
- B. Prescription of servient tenement.
- C. Revocation of servient tenement.
- D. All of the above.

17) Charlie lives next door to John and uses a portion of John's land as a driveway. As much as John likes Charlie, he does not want to grant him the use of the land in perpetuity. Since John wants to retain the privilege of reviewing the situation on a regular basis, John should grant Charlie a/an:

- A. License.
- B. Easement.
- C. Appurtenant easement.
- D. Permit.

18) All of the following constitute an encumbrance to real property EXCEPT:

- A. A will conveying the property to the owner's heirs upon death of the owner.
- B. A restrictive covenant in the deed to the property.
- C. A mortgage.
- D. A lease.

19) If two adjoining office buildings are separated by a common wall that is located on the property line, all of the following statements would be true EXCEPT:

- A. The wall is a party wall.
- B. Either owner can demolish his half without liability to the owner of the adjoining property.
- C. Each owner owns that portion of the wall on his land.
- D. Each owner has an easement in the other half of the wall for physical support.

20) What is the statutory right a widow has in the estate of her deceased husband?

- A. Dower right.
- B. Curtesy right.
- C. Tenancy at sufferance.
- D. Remainder interest.

21) Which of the following is an example of an appurtenant easement?

- A. A shared driveway.
- B. A power line.
- C. A license.
- D. An encroachment.

22) Alex conveys a parcel of real estate to Barry. Unless specified otherwise, one can presume that the transfer conveyed a:

- A. Life estate.
- B. Non-freehold estate.
- C. Remainder.
- D. Fee simple absolute estate.

23) When the term of an estate is measured by the life of someone other than the life tenant, it is called a:

- A. Life estate per autre *vie*.
- B. Life estate in reversion.
- C. Life estate in remainder.
- D. Non-freehold.

24) Fran conveys a life interest in a property to John. When John dies, the property will return to Fran's possession. Fran is a:

- A. Remainder person.
- B. Life tenant.
- C. Tenant per autre *vie*.
- D. Holder of a reversionary interest.

25) An owner, Jake, transferred a life estate in a home to Kate for the life of Lou. Kate then leased the property to Mike under a five-year lease. Owner Jake retained a future interest known as a/an:

- A. Remainder interest.
- B. Estate for years.
- C. Defeasible estate.
- D. Reversionary interest.

26) A conveyance from Harry to Jim for life, and then to Steve if still alive, would give Steve a:

- A. Contingent remainder interest.
- B. Vested remainder interest.
- C. Life estate.
- D. Reversionary interest.

27) An owner, Lee, transferred a life estate in a home to Leon for the life of Gary. Leon then leased the property to Mark under a five-year lease. What would happen if Leon dies?

- A. Mark's lease would terminate.
- B. Title would return to Lee.
- C. Gary would obtain title.
- D. Leon's heirs would be entitled to Leon's interest.

28) A utility company has the recorded right to erect poles on an owner's property and run electrical lines over it. The utility company has a/an:

- A. Negative easement.
- B. Prescriptive easement.
- C. Easement in gross.
- D. License.

29) An owner, Paul, transferred a life estate in a home to Sue for the life of Jane. Sue then leased the property to Steve under a five-year lease. The death of Jane would result in all of the following EXCEPT:

- A. Termination of Steve's lease.
- B. Termination of Sue's estate.
- C. *Reversion* to Paul.

- D. Jane's heirs taking Jane's interest in the property.

30) Life tenants may:

- A. Commit waste.
- B. Encumber the reversionary interest.
- C. Lease the property to others.
- D. Convey the estate by will.

31) A freehold estate:

- A. May last indefinitely.
- B. Is limited by a person's life.
- C. May not be encumbered.
- D. Is not inheritable.

32) An estate created when a tenant holds over at the end of a lease term without the landlord's permission is called:

- A. A periodic estate
- B. An estate at sufferance
- C. A tenancy at will
- D. An estate for years

33) An owner of a condominium leases it for one year. The type of estate the owner has created is a:

- A. Leasehold estate.
- B. Time-share.
- C. Tenancy by the entirety.
- D. Fee simple determinable.

Short-Answer Questions

- 1) Compare "Adverse possession" to "easement by prescription"
- 2) What is the difference between "reversionary interest" and "remainder interest"?
- 3) When a surviving equal-share partner becomes sole owner of a property upon his partner's death, how did the two partners originally hold title?

*Use your notebook for your description.

MORTGAGE INSTRUMENTS

A mortgage is a conditional conveyance of legal title to real property as security for the repayment of a debt. The history of the actual word "mortgage" is very interesting as it is derived from two French words "mort," from Latin - means "death" while "gage," means pledge or something deposited as a pledge of performance.

MORTGAGE

A **mortgage** is the *conveyance of an interest in real property to a lender as security for the payment of a note*. A mortgage is a type of security instrument, where the borrower (the mortgagor) pledges property to the lender (the mortgagee) as **collateral** for the debt, creating a **voluntary lien** on the property. Security instruments give the creditor some leverage against the debtor, and the debtor an extra incentive to pay. When the debt is repaid, the conveyance becomes void. Although there are actually many different types of mortgages, they all share many characteristics and have the same origins. So, the word mortgage literally means a "dead pledge" in that the property is forfeit or dead to the borrower if the loan is not repaid, and the pledge or conveyance is dead once the loan is repaid. For the **lender**, the main advantages of mortgages are the right to **accelerate** the entire debt in the event of default and the authority of the court for judicial foreclosure. The main disadvantage is the time and expense involved with judicial foreclosure. Legal fees and court costs can be several thousand dollars, which the lender may or may not recover from the sale, and the entire process can take several months or even years to complete. For the **debtor**, the advantages and disadvantages of mortgages are the opposite of the lenders. The lender's right of acceleration can mean that a borrower who misses one or two payments may have to pay off the entire debt to save the home, but the debtor usually has a long time to get the money together due to lengthy court proceedings.

Literally, a mortgage is a "death pledge." The borrower is referred to as the **mortgagor** and the lender is referred to as the **mortgagee**. The mortgagor pledges title to the mortgagee as collateral for a loan. When the loan is repaid the pledge is extinguished. Under old common law, the mortgagor did not receive possession of the property until the pledge was terminated. Today, a mortgagor retains possession of the mortgaged property and may enjoy all the rights of ownership so long as there is no default. Upon fulfillment of the terms of the mortgage, title reverts back to the mortgagor and the mortgage is discharged. The process of pledging property but maintaining possession is called **hypothecation**. See *Security Instruments* on page 3.

When a borrower is in **default** on a loan, the lender accelerates the due date of the debt to the present and gives the debtor notice of default demanding the full loan balance be paid at once. If the debtor fails to do so, the lender files a lawsuit, called a foreclosure action, in a court of jurisdiction where the land is located. There are some differences in how foreclosure proceedings progress, depending on the state and county in which the action takes place. We will look at one scenario that is typical of foreclosure proceedings, but keep in mind there may be variations in your jurisdiction.

Under a **foreclosure action**, the *court determines whether the lender is rightfully owed the money and if the borrower is in default*. If the court finds in favor of the creditor, the

creditor takes ownership and a judge will issue an order of execution directing an officer of the court, usually the county sheriff, to seize the property. If the creditor chooses to sell, the public is notified of the place and date of the sale via advertising that runs for a specified number of weeks in a newspaper circulated in the county. On the sale date, a public auction is held at the courthouse where anyone can bid on the property. The minimum bid is a set percentage of the appraised value (two-thirds is a common figure), as determined by three disinterested appraisers who live in the county. (The minimum bid requirement is set by law to protect whatever equity the debtor may have in the property, since a bidder cannot simply get a bargain by paying just the mortgage balance.) The property is sold to the highest bidder, with proceeds used to pay costs of the sale and to pay off the mortgages and liens. Any surplus funds (remaining after all debts, liens, expenses, and costs related to the property are paid) go to the debtor. See **more on foreclosure** on page 9.

FEDERAL GOVERNMENT: The Federal Government plays a key role in the national real estate market.

1. Passing legislation that affects mortgage lending in general.
2. Government-Sponsored loan programs that help borrowers in the purchase or refinance of residential real estate.

(Do not confuse these programs with government's involvement in the secondary market)

The three most common programs are:

- **FHA – Federal Housing Administration – Insured (Discussed in Chapter 9)**
- **VA – The Servicemen's Readjustment Act of 1944 – Guaranteed (Discussed in Chapter 9)**
- **Rural Development guaranteed and direct loans.**

Legal documents that establish the rights and duties of all parties involved in a transaction.

- **2 types of real estate finance documents:**
 - Financing instrument (promissory note)
 - Security instrument (mortgage)

PROMISSORY NOTE

A promissory note is the **evidence of a debt**, payment of which is secured by the mortgage. Instruments that evidence a promise to pay a specific person within a specific time frame A written promise to pay money One promising to pay is the "**maker**," the borrower One to whom payment is promised is the "**payee**," usually lender, which can also be the seller the note determines the interest rate, terms, and number of periodic payments on interest and principal. It also has provisions for late payment charges and real estate tax deposits. If payment is defaulted, the lender or holder of the note may sue directly on the note or foreclose the mortgage to recover the debt. Promissory notes or **note** are **negotiable instruments which convey security for a loan**, which means that they may be sold to a third person for legal consideration. However, they are not as easily negotiated as "bearer" notes since there is a named payee.

- Basic evidence of debt, showing who owes how much to whom.
- Typical promissory note includes:
 - Date
 - Names of parties
 - Amount of debt (and the interest rate/note rate)
 - How and when money is to be paid

- What happens in event of default?
- Signature of maker

FOUR NOTES USED IN REAL ESTATE TRANSACTIONS: The four types of notes usually used in real estate transactions are:

1. Straight Note:

- Calls for payments of interest-only during the term of the note,
- with a balloon payment at the end of the loan term to pay off the principal amount.

2. Installment Note:

- Calls for periodic payments of principal and/or interest,
- (in reality, a balloon payment may be required).

3. Partially amortizing installment note, or installment note with balloon:

- Periodic payments of principal and interest during loan term
- Balloon payment at end of term to pay balance.

4. Fully amortizing installment note:

- Regular payment of principal and interest,
- Calculated to pay entire balance by end of loan term.

Security instruments give a creditor the right to take ownership of the collateral through foreclosure if the borrower fails to pay the debt according to the terms of the agreement. The creditor may then choose to possess the property or sell it. Keep in mind, though, that a security instrument just describes collateral for a note. Even without a security instrument, the debtor is still obligated to pay the note. Usually accompany promissory notes. Security instruments allow debtor to **hypothecate** property.

Hypothecate: Debtor can pledge property as security for debt without giving up possession serves as security for creditor and motivation for debtor to fulfill terms of note. Failure to do so could result in loss of possession.

The two main types of security instruments used in real estate transactions are:

1. Trust deeds
2. Mortgages

DEEDS OF TRUST

Deed of trust is similar to a mortgage except that the borrower (**Trustor**) conveys title to a third person (**Trustee**) for the benefit of the lender (**Beneficiary**). The trustee has **naked or bare** title, which is then conveyed back to the borrower when the loan has been repaid. In case of default, the trustee sells the property at auction and applies the proceeds to satisfy the debt. One advantage to using a deed of trust rather than a mortgage is that the foreclosure process is not as expensive or as complex as a court-ordered proceeding.

- Instruments held by third party as security for payment of a note. Also called **Deeds of Trust**
 - Three-party device
 - Borrower is **trustor**.
 - Lender is **beneficiary**.
 - Independent third party is **trustee**.
- In states considered lien theory states, trust deeds create a lien against property in favor

of the beneficiary. This lien gives the creditor the right to force the sale of the property if the debtor defaults on payments under the note or trust deed.

THE DISTINGUISHING CHARACTERISTIC OF TRUST DEEDS: A creditor may begin a non-judicial foreclosure action when the debtor defaults on loan payments. This non-judicial action is authorized by a **power of sale clause** in the note or trust deed, which allows the trustee to sell the property without court supervision. The entire process of foreclosing and selling property through the power of sale clause may be concluded in well under a year, without the expense involved for court proceedings. The borrower, however, has the right to stop the sale and reinstate the loan by making up back payments (plus interest, trustee's fees, and attorneys' fees). Depending on the laws in a particular state, a non-judicial foreclosure action may allow questions to be raised about the validity of the sale and could lead to litigation over the title.

Helpful Hints: Equity

A property valued at \$200,000 with a \$120,000 mortgage has equity of \$80,000.

EQUITY: Equity is the difference between the value of a property and the total indebtedness.

TITLE THEORY VS. LIEN THEORY

Here are two theories concerning the legal effect of a mortgage: **(1) Title theory** and **(2) Lien theory**.

1. **Title Theory:** The title theory recognizes the mortgagee as the **legal owner** of the property, subject to the mortgagor's right to redeem title upon full payment of the debt. Upon default the mortgagee may take possession of the property and seize the rents.
2. **Lien Theory:** The lien theory interprets a mortgage purely as a lien on real property. Upon default the mortgagee would have to go through judicial foreclosure to take possession and be entitled to rents.
3. **Combination of the Two:** Most state laws have evolved into a hybrid of lien theory and title theory, with the actual laws falling somewhere between the two extremes of protecting the owner and protecting the lender. Although the exact details vary by state, most states recognize the mortgage as security, and the real estate as collateral. With a mortgage, the procedure in the event of default is judicial foreclosure. Judicial foreclosure under a mortgage requires a court-ordered sheriff's sale of the property to repay the debt. The method of foreclosure is determined by the terms of the mortgage. A mortgage is considered personal property, since it is an intangible right, which may be assigned by a sale, gift or will. Regardless of the theory used, a mortgage represents a claim or lien against title and is considered an encumbrance.

DEFEASANCE CLAUSE: Requirements of a valid mortgage are to be enforceable; a mortgage must meet the same requirements as a deed except that it contains a **defeasance clause** and provisions for default and foreclosure. A **defeasance clause** is used to defeat or cancel a certain right on the occurrence of a specific event. This clause can appear in contracts or mortgages. A defeasance clause can also give a borrower the right to redeem real estate after default on a note, by paying the full amount owed plus fees and court costs incurred in pursuing the defaulting party. The defeasance clause will outline the circumstances, procedures, and rules for the redemption to be successful.

RECORDING A MORTGAGE: Provides **constructive notice** of the lien and it establishes priority over all other subsequently recorded liens. The mortgage with the highest priority is referred to as the **first mortgage**.

RIGHTS OF THE MORTGAGEE: In case of default, the mortgagee has the right to sue the borrower for the amount due on the note or to sell the property at foreclosure. The mortgagee also has the right to sell the mortgage and note to a third party by means of an **assignment**.

RIGHTS OF THE MORTGAGOR: The mortgagor has the following rights:

1. **Possession and Enjoyment of the Property until Default.**
2. **Release of the Mortgage upon Performance.**
3. **Right of Redemption after Default.**

OBLIGATIONS OF THE MORTGAGOR: The mortgage imposes certain **covenants** to be met by the mortgagor in order to avoid default. They are:

1. **Repay the Loan.** Repayment terms are described in the promissory note.
2. **Maintain Proper Insurance.** The mortgagee must be named as beneficiary in the policy.
3. **Prevent Waste.** The buildings must be properly maintained to protect the value of the collateral.
4. **Maintain the Improvements.** No improvements may be removed or altered without the permission of the mortgagee.
5. **Pay all Taxes and Assessments when Due.**

RELEASE OF A MORTGAGE: When the mortgage has been paid off the mortgagee must acknowledge **satisfaction** of the debt and return the cancelled promissory note and mortgage to the borrower. In addition, the lender must execute a **mortgage release ("Satisfaction Piece")**, which is recorded by the borrower as proof that the mortgage has been discharged. **Note:** A "satisfaction" or "release of mortgage" is the best proof that a mortgage has been paid in full.

FINANCING INSTRUMENT PROVISIONS

Various clauses are used in mortgages to give certain rights to the lender or borrower. Many of these clauses can be found in the promissory note or security instrument, and often they appear in both.

ACCELERATION CLAUSE: An acceleration clause allows the mortgagee the right to declare the entire amount of the note payable in full upon the happening of a certain event such as missing a payment or selling the property. An **acceleration clause** gives the lender the right to declare the entire loan balance due immediately because of borrower default or for violation of other contract provisions. Most promissory notes, mortgages, trust deeds, and land contracts contain an acceleration clause allowing the lender to accelerate the debt upon default as defined in the contract. This is important to lenders because, upon default, they want to be able to make all payments due without having to file a separate action for each missed payment.

Extra Info

- The actions that constitute default are defined in the contract.
- A debtor who misses one payment may discover next month that, not just two payments are due but rather, the entire loan balance is due because of the missed payment.

- Most lenders, though, will wait until payments are delinquent at least 90 days before enforcing an acceleration clause that appears in the mortgage or note—but never take this for granted.

ALIENATION OR DUE-ON-SALE CLAUSE: A due-on-sale clause accelerates the due date on the note if title to the mortgaged property is transferred. **Note:** A due-on-sale clause allows the lender to demand the entire loan due when the borrower conveys title. The purpose of a due-on-sale clause is to prevent a sale with a mortgage take-over. A due-on-sale clause is also referred to as an **alienation or non-alienation clause**. **Note:** An alienation clause protects the mortgagee's security position by *adding stipulations such as calling the note due by conveyance of the property*.

An **alienation clause** in a contract *gives the lender certain stated rights when there is a transfer of ownership in the property*. It may also be referred to as a **due on sale clause**. This is designed to limit the debtor's right to transfer property without the creditor's permission. Depending on the actual wording of the clause (that's why lawyers are important); alienation may be triggered by a transfer of title, by transfer of a significant interest in the property, or even by abandonment of the property. Transfer of a significant interest can be construed as an obvious long-term lease, but often is also interpreted to cover a lease with option to buy or a land contract.

On sale or transfer of a significant interest in the property, the lender will often have the right to accelerate the debt (here called a due on sale clause), change the interest rate, or charge a hefty assumption fee. Adjustable-rate mortgage (ARM) loans seldom have an alienation clause that calls for an interest rate change since the rate can already be adjusted under the original contract. An ARM loan may have other alienation provisions, however, such as an assumption fee. The lender may choose which, if any, options stated in the contract it chooses to enforce. This is true for most conventional loans. Although FHA and VA loans cannot, technically, have alienation clauses, they still attempt to restrict transfers in other ways, such as by reserving the right to approve a new debtor who will take over an FHA or VA loan.

****Extra Info****

For conventional loans, states tried to restrict enforcement of due on sale clauses. But in the 1982 landmark U.S. Supreme Court case of ***Fidelity Savings and Loan v. De La Cuesta, ET. al.***, the Court ruled that federally chartered S & Ls could follow federal Office of Thrift Supervision rules allowing due on sale clauses, instead of following state laws that attempted to limit this right. Later that same year, the U.S. Congress passed the Deposit Insurance Flexibility Act (Garn-St. Germain Act) extending this right of pre-emption of state laws limiting due on sale clauses so all lenders can now enforce due on sale clauses. This law has led to a new problem that has yet to be addressed adequately. Lenders often have alienation clauses and prepayment penalty clauses in contracts. Essentially, the lender could collect additional fees or penalties twice—once under the provisions of each clause. Several rules or regulations have been proposed that would eliminate this problem by forcing lenders to choose to enforce one or the other of these clauses, but no new rules have yet been enacted. Of course, with increased competition in the home mortgage market, lenders do not have free reign to charge exorbitant fees. It is important, nevertheless, for buyers and sellers (and others) to be aware that this situation may exist.

NONRECOURSE LOAN: A loan with a nonrecourse provision relieves the borrower of personal liability on the note. A nonrecourse loan is used when the lender feels certain that the collateral is sufficient to cover the amount of the loan.

LATE CHARGE PENALTIES: In Massachusetts, lenders may charge a maximum of 3% for payments fifteen days overdue on owner-occupied houses of up to four units.

TAX AND INSURANCE ESCROW: Most mortgages require the mortgagor to make a monthly payment into an **escrow** or reserve account to meet future real estate taxes and insurance premiums. At the closing, the borrower deposits sufficient funds in the escrow to cover the unpaid taxes; thereafter, the monthly payments include principal, interest, taxes, and insurance premiums (**PITI**).

SUBORDINATION CLAUSE: A subordination clause allows the mortgagor to make an existing mortgage subordinate to additional financing. A **subordination clause** in a contract gives a mortgage recorded at a later date the right to take priority over an earlier recorded mortgage. Normally with mortgages, trust deeds, and other real estate contracts, the first instrument or document recorded gets lien priority. Lien priority is the order in which liens are paid off out of the proceeds of a foreclosure sale. This is important because the lien with the highest priority gets paid first out of the proceeds of a foreclosure sale. The subordination clause usually states that the instrument that contains the clause will be subordinate (junior) to another loan lien (mortgage, trust deed, etc.) to be recorded later. The inclusion of a subordination clause is something that must be negotiated at the time of entering into the earlier transaction. Once the first instrument is recorded, it is usually too late to make this kind of arrangement with the lender. Subordination clauses are also common in-home equity loans or lines of credit, where the holder of the junior second mortgage agrees to a subordinate position even if the homeowner later refinances the first mortgage.

Helpful Hints: Subordination Clause

A property is sold, and the seller takes back a deferred purchase money mortgage. Subsequently, the buyer applies to a bank for additional financing. Since the bank requires its mortgage to have priority over all other liens, the seller's mortgage would have to be made subordinate to the new mortgage.

PREPAYMENT PENALTY CLAUSE: Although the borrower has the right to prepay a mortgage at any time, a penalty may be charged if more than a certain percentage of the loan is paid in any given time period. This is referred to as a **closed** mortgage. An **open** mortgage is one that may be paid in full at any time without penalty. A **prepayment clause** in a contract *gives the lender the right to charge the borrower a penalty for paying off the loan early*, such as when refinancing a loan.

While the time periods and amount of the penalty may vary considerably, basic effect of a prepayment clause is to charge the debtor extra money to make up for the interest income the lender loses when the debtor pays the loan early.

ASSIGNMENT CLAUSE: An assignment clause gives the mortgagee the right to assign the mortgage to a purchaser of the promissory note. The **assignor** is the one who assigns (sells) the debt and security. The **assignee** is the one who receives (buys) the instruments. Selling existing mortgages by one investor to another is known as **trading in the secondary mortgage market**. This occurs in situations such as when the primary lender or loan originator sells a mortgage to the Federal National Mortgage Association in order to free up cash for future loans. In most assignments the mortgagor is not notified of the transfer and continues making payments to the original mortgagee who **services the loan** by collecting the payments, handling payoffs, releases, and delinquencies.

ESTOPPEL CLAUSE: An estoppel clause bars the mortgagor from challenging the terms of the mortgage or the amount due on principal and interest in the event that the mortgage and note are assigned to a third party. The estoppel clause acknowledges the unpaid amount of the debt, the interest rate, and date up to which interest is paid for the protection of the assignee. Some mortgages contain an additional clause requiring the borrower to sign an **estoppel certificate** when the mortgage is assigned. This is also referred to as a "**certificate of no defense**".

PARTIAL RELEASE CLAUSE: A partial release clause allows the mortgage to be released from a portion of the security without releasing the entire mortgage. A bank can partially release a mortgage on a lot in subdivision to allow the developer to build a home on the lot and to sell it to a buyer. A **partial release, satisfaction, or conveyance clause** in a contract obligates the creditor to release part of the property from lien and convey title to that part back to the debtor once certain provisions of the note or mortgage have been satisfied. Usually, this occurs after a certain percentage of the mortgage balance has been paid. This is an important clause that appears in many blanket mortgages and some construction mortgages developer or builder can sell off completed homes with clear title before having to pay back the entire amount borrowed for the entire development project. Also, if the land is bought with a mortgage, construction financing is much easier to obtain later when the builder owns part of the land free of liens.

OTHER MORTGAGE CLAUSES AND COVENANTS: In addition to the typical clauses discussed that appear frequently in real estate mortgages, there are also a number of covenants. Covenants, simply, are *promises*. Covenants can appear in deeds, mortgages, or any other document. Typical covenants can compel or prevent certain actions by the property owner or uses for the property. Typical covenants in mortgages that the property owner must sign include provisions protecting the lender's security interests in the property. These covenants include such things as the property owner promising to keep the property in good condition and repair, not damaging or diminishing the value of the property in any way, promising to keep fire, hazard, and flood insurance in force on the property, and agreeing to pay taxes and other assessments on time. Failure to keep any of these promises or covenants can be cited in the mortgage or note as causing the borrower to be in default. There are, of course, a number of other clauses and covenants important to typical mortgages. Borrowers should make sure they understand them and should be encouraged to consult legal counsel before entering into a mortgage.

INTEREST: Interest is a **charge** paid for the use of borrowed money. The rate of interest and method of payment are specified in the promissory note. Interest may be paid **in advance or in arrears** at the end of each month.

USURY LAWS: States may enact usury laws, which determine the maximum rate of interest for first and second mortgages. During the 1970's when interest rates rose dramatically, the VA/FHA interest rates were higher than those allowed by some state usury laws. As a result, effective March 31, 1980, federal law exempted residential first mortgage loans from state interest limitations.

BALLOON PAYMENT: A final payment on a mortgage loan, which is larger than the preceding periodic payments and usually pays off the loan in full, is known as a balloon payment.

DEFAULT AND FORECLOSURE

DEFAULT: A mortgagor is in default when he or she fails to comply with the terms of the mortgage or fails to make the monthly payments as required by the promissory note. The promissory note usually requires a late payment fee and allows a grace period to bring the payments up to date. On an FHA loan, the grace period is three months. If payments are not received within the grace period, the mortgagee may accelerate the note by declaring the entire loan balance due and payable at once and proceed to foreclose.

Debtors may be able to redeem (save) their property from the time a *notice of a pending foreclosure*, called a **lis pendens**, and is filed until the confirmation of the foreclosure sale. This is done by paying the court what is due, which may include court costs and attorneys' fees.

- In some states, this right to *save or redeem the property prior to the confirmation of sale* is called the **equitable right of redemption**.
- Some other states use the **statutory right of redemption**, which allows debtors to redeem themselves *after the final sale*.
- Once the redemption is made, the court will set aside the sale, pay the parties, and the debtor gains title to the property again.
- Debtors may avoid foreclosure by making a **voluntary conveyance** of property (also called **deed in lieu of foreclosure**)
- Debtors still lose property, but by conveying it voluntarily before final court action, can avoid a foreclosure on their credit report.
- After confirmation of sale, it is too late.
- Lender not obligated to accept deed in lieu of foreclosure as full satisfaction of debt and could pursue deficiency judgment.

FORECLOSURE: Foreclosure is the process of terminating a defaulted mortgagor's **equitable right of redemption**. Foreclosure methods vary depending upon the jurisdiction. Generally, there are two kinds of foreclosure proceedings:

1. **Judicial Foreclosure.** This method requires the lender to bring a lawsuit asking the court to cut off the borrower's rights and to allow a sale of the property at public auction to satisfy the debt. The borrower may be allowed up to a year or more to bring the payments up to date.
2. **Statutory Foreclosure.** Most states have passed legislation providing for a quicker method of foreclosing a mortgage. Generally, lenders are permitted to make an **entry** and to take **possession** of the mortgaged property without having to ask for court permission. If the **deficiency** is not paid within a required time period, the mortgagor's equitable right of redemption is terminated, and the mortgage debt is deemed paid to the extent of the value of the property. While in possession, the lender has the right to the rents and must manage and maintain the property for the benefit of the mortgagor. Any net income after expenses must be applied to the reduction of the debt.

POWER OF SALE FORECLOSURE: In Massachusetts, mortgages contain a "**power of sale**" clause, which gives the lender the right to foreclose a mortgage by selling the property at public auction. Notice of the sale must be given to the mortgagor by registered mail and newspaper publication. If the sale is fairly conducted and notice of the sale is properly recorded, the mortgagor's **equitable right of redemption is terminated at the moment of the sale**. The lender is required to file a sworn statement with the Land Court indicating compliance with the **Soldiers and Sailors Civil Relief Act** which bars a foreclosure against a

person in military service or until the person has been out of service for three months.

MORTGAGOR'S EQUITABLE RIGHT OF REDEMPTION: The equitable right of redemption allows the mortgagor in default to redeem title prior to a foreclosure sale. In Massachusetts, the equitable right of redemption is terminated at the moment of the foreclosure sale. Title may not be redeemed after the sale, as with tax sales or sheriff's sales. Some states have a **statutory right of redemption**, which allows the borrower to redeem title within a certain time period after the sale by paying the sale price, interests, and costs. Massachusetts has no statutory right of redemption.

DEFICIENCY DUE AFTER SALE: Any excess proceeds of the foreclosure sale after deducting expenses are paid to the mortgagor. However, if the proceeds of the sale are insufficient to pay the amount due plus costs, the borrower is liable for the deficiency unless it is a **nonrecourse loan**. The deficiency may be forgiven by the bank, in which case it is treated as taxable income to the mortgagor.

EFFECT OF A MORTGAGE FORECLOSURE SALE UPON OTHER LIENS: A foreclosure sale concludes the rights of all lien holders of record dated subsequent to the mortgage, except for federal, state and city tax liens, and labor liens. The purchaser at foreclosure sale receives a deed containing no warranties, subject to all restrictions and easements of record, unpaid taxes, and labor liens. **Note:** Payment of back-taxes always takes priority over other debts following a foreclosure sale.

DEED IN LIEU OF FORECLOSURE: In order to avoid the expense of a foreclosure sale, the mortgagee may accept a deed (**friendly foreclosure**) from the mortgagor in full payment of the debt. However, the disadvantage to this is that the conveyance is subject to all the existing liens, whereas they would be eliminated by a foreclosure sale.

BANKRUPTCY - EFFECT UPON FORECLOSURE: Filing for bankruptcy by the mortgagor will prevent or delay a foreclosure sale until the bankruptcy court determines the rights of all creditors. Eventually, a sale will be permitted with the same results.

SECOND MORTGAGES

Basically, all mortgages are written alike, regardless of whether they are first, second, or third mortgages. The determining factor of the priority of a mortgage is the recording date. Thus, if there are two mortgages on a property, the one first recorded is the first mortgage, and the latter is the second or **junior mortgage**. In the event of default and foreclosure on either mortgage, the proceeds of the sale are credited first to satisfy the first mortgage debt. The priority of mortgages may be changed by a **subordination** agreement executed by the mortgagor and mortgagee.

Because of the risk involved, interest rates on junior mortgages are generally higher and the terms shorter, resulting in high monthly payments. Consequently, most lenders do not permit the buyer to finance the down payment with a second mortgage, insisting that it be paid in cash. Frequently, when a young buyer receives a cash gift from a parent for the down payment, the lender will require the donor to certify in writing that it is a gift and not a loan. For all home mortgages, which must meet HUD requirements, the borrower is required to certify that the down payment is being made in cash.

Junior mortgages and purchase money mortgages are most commonly used to finance the purchase of income properties. The seller is usually willing to take back a second or third mortgage to cover part of the down payment to complete the sale. If the effective net income is sufficient to cover the payments on both mortgages, the holder of the first mortgage is less likely to object to the junior financing.

PURCHASE MONEY MORTGAGE: A (deferred) purchase money mortgage is taken back by the seller to defer the payment of part of the purchase price. It may be a first or a second mortgage.

EQUITY MORTGAGE: A homeowner's equity may be used as collateral in order to establish a line of credit. The lender agrees to advance funds up to a maximum of seventy or eighty percent of the value of the home over and above any first mortgage. The loan is secured by an open-end mortgage with an adjustable interest rate at one or two points over the prime rate. The borrower does not have to use all the money available and pays interest only on the money borrowed. The Tax Reform Act of 1986 has resulted in a growing demand for equity loans, since the tax deduction allowed for consumer purchase loan interest has been phased out. Closing costs for an equity loan are usually lower than a conventional loan since the loan does not have to meet the secondary mortgage market requirements.

MORTGAGE TAKE-OVER

TAKE-OVER MORTGAGE: If the seller has an existing, **assumable** mortgage, it is often to the advantage of both parties to sell the property with the buyer taking subject to or assuming the existing mortgage as part of the consideration. Selling subject to a mortgage is not possible if the mortgage contains a **due-on-sale clause** or **non-alienation clause**. Most conventional mortgages are not assumable. VA/FHA mortgages are assumable by lender-qualified buyers.

EFFECT OF A MORTGAGE TAKE-OVER: The buyer receives title subject to the seller's mortgage and takes over the monthly payments. Unless released by the lender, the seller remains principally liable for the debt and is responsible for any deficiency in the event of foreclosure. If the buyer agrees to **assume the mortgage**, the buyer becomes equally responsible with the seller to the mortgage holder. The original borrower may be released only by a **novation** in which the lender substitutes the new owner as the party primarily liable for the debt.

SPECIAL PURPOSE FINANCING

Special Purpose Financing includes a variety of mortgages and innovative financing methods, which are designed to meet specific, needs. These financing techniques vary according to their purpose and according to who is making the loan. Special purpose financing includes the following:

BLANKET MORTGAGE: A blanket mortgage covers more than one parcel of real estate, providing for partial release upon repayment of portions of the debt. Covers more than one parcel of land or lot; usually used to finance subdivision developments usually has a **partial release clause** allows borrower to pay a certain amount to release some lots, with mortgage continuing to cover remaining lots.

BRIDGE MORTGAGE: A bridge loan is taken on the equity of a seller's house to raise cash

for the purchase of a new home. A bridge loan makes it possible for the seller to purchase a new home prior to selling the old one. A bridge loan is a form of **equity loan**. Occurs between termination of one mortgage and beginning of the next when next mortgage is taken out, bridge mortgage is repaid. Designed to be temporary and used most commonly for construction financing. A less common use is to buy a new home before selling the old one.

CHATTEL MORTGAGE: A chattel mortgage is used to secure a lien on personal property. In most states, the use of a chattel mortgage is being replaced by security agreements under the **Uniform Commercial Code**.

CONSTRUCTION MORTGAGE: A construction loan is a short-term loan to cover the construction costs of a building or development. The money is advanced to the builder at certain stages in the construction. Because of the greater risk, construction loans are usually made at higher-than-market interest rates. The builder must supply the lender with releases of all mechanic's liens for work covered by the payment. The lender usually requires a "**take out**" provision for permanent financing to pay off the construction loan when the project is completed. Construction loans can be profitable, but lenders regard them as risky. Thus, not only do they charge high interest rates and loan fees on construction loans, they also closely supervise the disbursement of funds to ensure that projects are completed. There is always the danger that a borrower will overspend and exhaust the loan funds before construction is complete. If the borrower does not have money to finish a project, the lender is left with a partially completed project that cannot be sold easily in its existing state—with a very real possibility of foreclosure. For example, if a developer is building a 20-unit condominium project, a lender might not just loan a certain percentage of the predicted future total value of the condominium, but only a certain percentage of the value of the condominium project if, because of an emergency or unforeseen circumstance, the entire building had to be sold at once to one buyer (known as a bulk sale). Since the realizable sales price in this case might be much lower, the maximum loan many lenders would extend would be much lower.

END LOAN: As an inducement to taking a construction loan, the lender may require that the final or **end** loans to the eventual buyers are placed with the same bank. End loans are also referred to as "take-out" loans.

EQUITY PARTICIPATION MORTGAGE: Permits lender to share part of the earnings, income, or profits from a real estate project usually in addition to collecting principal and interest payments on the loan. A lender may receive 5% of gross rents done mostly for commercial real estate projects.

GRADUATED PAYMENT MORTGAGE (GPM): A graduated payment mortgage (GPM) is a specialized payment structure that allows the borrower to make smaller payments in the early years of a mortgage. The lower payments in the early years of a mortgage structured in the note as a GPM are not sufficient to cover the interest due on the loan, and so the unpaid interest is added to the loan balance, resulting in a scheduled period **negative amortization**. At a predetermined point in the loan term, the payments escalate on a scheduled basis until they eventually reach the point in which they are sufficient to fully amortize the loan over the remainder of its term.

OPEN-END MORTGAGE: An open-end mortgage allows the borrower to increase the loan up to a maximum amount without having to refinance. The lender can advance additional funds, which will be secured by the original mortgage, thus saving the borrower additional closing costs. An open-end mortgage is used for an **equity** loan in which the borrower may receive cash advances up to an established maximum credit line. Most mortgage documents that lenders use say, “open-end mortgage” on them. An **open-end mortgage** allows the borrower to request additional funds from the lender, usually up to a certain pre-defined limit. In most cases, lenders will not advance funds in excess of the original principal balance of the loan or that exceed a predetermined loan-to-value.

Helpful Hints: Open-end Mortgage

A borrower obtains an open-end mortgage to buy a home. Under the terms of the mortgage, he may borrow additional funds over the term of the loan as long as the unpaid principal does not exceed 80% of the appraised value of the property used as collateral.

-or-

Another type of open-end loan is a home equity line of credit, in which a borrower can borrow, repay, and borrow again up to the pre-defined limit. Do not confuse an open-end mortgage with an open mortgage, which is a term used to describe a mortgage that may be repaid at any time without penalty.

PACKAGE MORTGAGE: A package mortgage is a type of residential mortgage, which covers the real estate, as well as certain equipment and appliances located on the premises. Includes personal property, like appliances, in the property sale and all are financed in one contract. Personal property also serves as collateral for loan. Common use is to buy a furnished condominium. Loan and mortgage documents may also recite appliances and/or furniture as part of transaction. Lender should obtain a financing statement or UCC filing to claim covered personal property as collateral.

PERMANENT CONSTRUCTION LOAN: A special type loan where there is only one loan and one closing, with no take-out loan. Fixed disbursement schedule for loan funds. Loan automatically converts to a permanent first mortgage when construction is finished.

REVERSE ANNUITY MORTGAGE (RAM): A reverse annuity mortgage allows a property to be mortgaged to get a flow of periodic payments from the lender. The lender pays out the loan, not in one lump sum, but monthly, over a five or ten-year period. Part of the monthly cash payment is withheld to pay the interest on the loan. A RAM will provide a monthly income for an elderly homeowner with little or no income. If the borrower survives the terms of the annuity, the loan must be repaid. Otherwise, the loan will be paid out of the borrower's estate or from the proceeds of the sale when the property is sold. Allows qualified senior homeowners over the age of 62 to convert equity into monthly income stream or line of credit. Borrower must have substantial equity in home. Mortgage is repaid when:

- Home is sold.
- Borrower does not occupy the home for 12 consecutive months.
- Borrower dies.
- Also called:
 - Reverse annuity mortgage
 - Reverse equity mortgage
 - Home equity conversion mortgage

WRAP-AROUND MORTGAGE: This is a method of financing in which a second mortgage is written for the amount of the second loan plus the balance due on the first mortgage. The mortgagor makes one payment to the holder of the second mortgage who assumes the responsibility for paying the first.

Wrap-around mortgages may also be used to finance the purchase of property with the seller taking back a wrap-around as part of the purchase price. However, since there is a change of ownership, the first mortgage would have to be assumable for it to work.

The term **wraparound mortgage** is used to describe a financing arrangement in which an existing loan on a property is combined with a new loan. This type of arrangement could be used in lieu of traditional refinancing where a lender makes a second loan to a borrower, leaving the first loan intact. The borrower pays the wraparound lender a single payment on the combined principal. If the wraparound lender is not the original lender, then the wraparound lender makes payments on the original mortgage to the first mortgage lender. This type of arrangement gives a borrower more favorable terms than a typical refinance since the wraparound lender is advancing only the difference between the unpaid first mortgage and the combined principal of both loans. Less commonly, a wraparound mortgage could be used as a form of seller financing. The borrower makes full payment to the holder of the wraparound mortgage (the seller), who in turn makes payments on the original mortgage. For this arrangement to be proper and legal there must be an assumable first mortgage, with bank approval for the wraparound loan. Otherwise, the seller may be violating any due-on-sale clause.

FIXED DISBURSEMENT PLAN: Fixed Disbursement Plan; Pays a percentage of funds at a set time Series of predetermined disbursements, called obligatory advances, paid at various stages of construction t will release only 10% of the funds when a project is 20% complete, with future draws of 20% each time construction progresses 20% more toward completion.

Example:	First Release/Draw	10% of Loan	Project 20% complete
	Second Release/Draw	20% of Loan	Project 40% complete
	Third Release/Draw	20% of Loan	Project 60% complete
	Fourth Release/Draw	20% of Loan	Project 80% complete
	Fifth Release/Draw	20% of Loan	Project 100% complete

- Lenders often hold the final 10% (or more) of the loan proceeds until the lien period has expired to protect against unpaid mechanic's liens, which could affect the marketability of the property.
- If a valid mechanic's lien is recorded, the construction loan agreement usually allows lenders to pay it from the part of the loan not disbursed.
- Voucher System. The contractor or borrower must pay his or her own bills, and then

Helpful Hints: Wrap-Around Mortgage

An owner has a mortgage with a balance due of \$40,000 at 10% interest and needs an additional \$20,000 financing. The owner takes out a second mortgage for \$60,000 at 11% interest with a new lender and receives \$20,000 cash. The owner makes a single monthly payment on the \$60,000 loan to the second mortgagee who agrees to take over the payments on the owner's first mortgage. As a profit incentive, the second mortgagee will earn 1% interest on the \$40,000 balance of the first mortgage. In the event the second mortgage holder defaults on the payments on the first mortgage, the owner would have the right to withhold payments on the second and make direct payments to the first.

submit the receipts to the lender for reimbursement.

Warrant System: The lender directly pays bills presented by the various suppliers and laborers on a project.

Voucher System: Requires contractor or borrower to pay own bills and submit receipts to lender for reimbursement.

ADVANCE FINANCING TECHNIQUES: Investors and property developers have devised financing techniques, which provide a greater incentive to the lenders through the sharing of the profits of the venture.

SHARED APPRECIATION MORTGAGE: A shared appreciation mortgage loan is made at a reduced interest rate in return for which the lender shares in the appreciation of the mortgaged property when the property is sold. A developer could obtain a construction loan at two points less than the current market rate of interest in return for which the developer agrees to pay the lender one third of the appreciation when the property is sold.

EQUITY SHARING (PARTICIPATION): Equity sharing is an arrangement between a buyer and an investor, whereby the investor puts up all or part of the down payment and closing costs and assists in the monthly mortgage payments. In return, the investor is permitted to buy a share of the equity at a discount. A bank could lend \$5 million dollars at an attractive interest rate in return for being able to buy a half interest in the equity for \$500,000. Another variation of equity sharing is discussed on Page 9-14.

CREATIVE FINANCING: This is a term used to describe any financing method that will help close a sale during a tight money market or involving unusual circumstances. Creative financing includes such methods as equity sharing, reverse annuity mortgages, buy-downs, installment sales, purchase money mortgages and mortgage take-overs. Creative financing is fully discussed in Chapter 9.

MORTGAGE

I (WE) _____ of _____ County _____ Massachusetts (Mortgagor), being Unmarried, for consideration paid, GRANT TO _____ of _____, Massachusetts (Mortgagee), with mortgage covenants to secure the payment of \$ _____ in _____ years with _____% interest per annum, payable monthly as provided in our promissory note executed this date.

THE LAND IN _____, MA known as _____, and bounded and described as follows:

NORTHERLY by _____
EASTERLY by _____
SOUTHERLY by _____
WESTERLY by _____

Containing in all _____ square feet of land more or less.

Being the same premises conveyed to _____ by Deed of _____ dated ____ / ____ / 20____

To have and to hold the said real estate to the said mortgagee to its own use and behoove forever: and we hereby covenant that _____ the lawful owner(s) of said property; that _____ have good right to sell the same; that the same is free from all encumbrances; and that _____ will warrant and defend the title against the lawful claims and demands of all persons.

PROVIDED HOWEVER, that if _____ shall perform the following:

- 1. Pay to the mortgagee the sum of \$ _____ with interest as above;
2. Keep the property insured for _____ for the benefit of the mortgagee and in such companies and such form as the mortgagee shall approve;
3. Keep the property in good condition to prevent waste;
4. Shall not remove any buildings or improvements from the property.
5. Pay all taxes and assessments when due.

THEN IF ALL THESE BE PERFORMED, this DEED and the said note SHALL BE NULL AND VOID and the legal title to the property reverts to me/us _____.

BUT SHOULD THERE BE ANY DEFAULT, the mortgagee may sell the property at public auction, first giving me/us _____ days' notice in writing of the time and place of such sale, and by publishing said notice once a week for three consecutive weeks in a newspaper published in said _____. And out of the money arising from said sale, the mortgagee shall retain all sums due under this mortgage, including all costs, charges, and expenses and including all sums used to discharge any claims or liens on the property rendering the surplus, if any, to me/us.

AND IT IS AGREED that the mortgagee may purchase at any such sale; and that until default the mortgagor may retain possession of the property and may use and enjoy the same; but after such default the mortgagee may enter and take immediate possession, authority for which is hereby given. This mortgage is upon the STATUTORY CONDITION with statutory power of sale.

WITNESS _____ hand (s) and seal (s) this _____ day of _____, 20____.

COMMONWEALTH OF MASSACHUSETTS

County of _____ SS _____ DATE: _____

On this _____ day of _____, 20____ before me, the undersigned notary public, personally appeared _____, proved to me through satisfactory evidence of identification, which was/were _____, to be the person(s) whose name is signed on the preceding or attached document(s), and acknowledged to me that _____ signed it voluntarily for its stated purpose.

NOTARY PUBLIC
My commission expires:

KEY WORDS AND PHRASES

Acceleration clause	Alienation clause	Assignment	Acceleration clause	Advance financing techniques	Alienation
Assignment clause	Assumable mortgage	Assume and agree to pay	Bankruptcy	Balloon payment	Beneficiary
Blanket mortgage	Bridge loan	Chattel mortgage	Closed mortgage	Construction mortgage	Creative financing
Deed in lieu	Deed of trust	Default Defeasance clause	Deficiency	Due-on-sale clause	End loan
Equitable right of redemption	Equity	Equity mortgage	Equity participation	Equity sharing	Estoppel
Fixed disbursement plan	Federal government	Foreclosure	Graduated payment mortgage	Hypothecation	Interest
Junior mortgage	Lien theory	Mortgage	Mortgage take-over	Mortgagee	Mortgagor
Naked title	Negotiable instrument	Non-alienation clause	Non-recourse loan	Open-end mortgage	Package mortgage
Partial release clause	Permanent construction loan	Power of sale foreclosure	Prepayment penalty	Promissory note	Purchase money mortgage
Recording (mortgage)	Release	Reverse annuity mortgage	Satisfaction piece	Second mortgages	Security instruments
Shared appreciation mortgage	Statutory right of redemption	Subject to mortgage	Subordination clause	Take-out loan	Title theory
Usury laws	Voucher system	Warrant system	Wrap around mortgage		

Multiple Choice Questions

1) A mortgage note is:

- A. A security for a debt.
- B. Evidence of a debt.
- C. A lien against real property.
- D. An encroachment.

2) A deed of trust financing arrangement gives title to the secured property to the:

- A. Lender. C. Trustee.
- B. Trustor. D. Seller.

3) A buyer finances 80 percent of the \$100,000 sales price of a property with a new loan and puts down \$10,000. He asks the seller to take back a second mortgage for the balance. The second mortgage is a:

- A. Blanket mortgage.
- B. Senior mortgage.
- C. Purchase money mortgage.
- D. Swing loan.

4) Which of the following could change the relative priorities of two mortgages on a property?

- A. Vendor's affidavit.
- B. Subrogation agreement.
- C. Subordination agreement.
- D. Partial release.

5) A blanket mortgage is used to:

- A. Pledge more than one piece of property as security for a debt.
- B. Pledge personal property as security for a debt.
- C. Secure a debt on an interim basis.
- D. Replace a short-term personal note.

6) Which of the following would probably not be recorded?

- A. Promissory note.
- B. Deed of trust.
- C. Land contract.
- D. Purchase money mortgage.

7) The clause in a mortgage that allows the lender to declare the outstanding

balance of the loan due upon sale of the mortgage property is known as:

- A. Equity of redemption.
- B. Escalation clause.
- C. Habendum clause.
- D. Acceleration clause.

8) All of the following statements are true about a promissory note EXCEPT:

- A. It is a personal obligation of the borrower.
- B. It is recorded with the mortgage.
- C. It is evidence of the debt.
- D. It is executed by the borrower.

9) All of the following are characteristics of a construction loan EXCEPT:

- A. Mechanic's liens are released at various stages of construction.
- B. It contains a provision for end loans to be placed with the same lender.
- C. The interest rate is higher than market interest rates.
- D. There is a one-time disbursement of funds.

10) The right to regain title after a foreclosure sale is called:

- A. The equity of redemption.
- B. Quiet enjoyment.
- C. The statutory right of redemption.
- D. Alienation.

11) In a mortgage takeover situation, a seller can be relieved of liability on the mortgage by finding a buyer who will:

- A. Take the property subject to the loan.
- B. Assume the loan through novation.
- C. Subordinate the loan.
- D. Subrogate the loan.

12) A statutory right of redemption period under a foreclosure occurs:

- A. During the default period.
- B. During the time between default and the foreclosure sale.
- C. After the default judgment is rendered.
- D. After foreclosure sale.

13) Should a borrower fail to make

payments when due, the lender may demand immediate payment of the entire balance under the terms of the:

- A. Prepayment clause.
- B. Defeasance clause.
- C. Acceleration clause.
- D. Hypothecation clause.

14) A borrower's property serves as collateral while the borrower retains the right of possession and use by the process of:

- A. Alienation. C. Amortization.
- B. Hypothecation. D. Acceleration.

15) A mortgage becomes null and void when the note is paid in full under the terms of the:

- A. Defeasance clause.
- B. Prepayment clause.
- C. Alienation clause.
- D. Hypothecation clause.

16) An owner's right to redeem title after default, but prior to foreclosure, is called the:

- A. Statutory right of redemption.
- B. Equitable right of redemption.
- C. Defeasance clause.
- D. Subordination agreement.

17) A legal instrument which prevents one from disaffirming what he/she has already stated as being true is called a/an:

- A. Recital. C. Novation.
- B. Finder. D. Estoppel certificate.

18) The party that is obligated to a debt secured by a mortgage is the:

- A. Mortgagor. C. Mortgagee.
- B. Obligor. D. Obligee.

19) When a real estate mortgage is foreclosed, unpaid real estate tax liens against the property:

- A. Are cut off.
- B. Become a lien on the personal property of the delinquent mortgagor.

- C. Remain in force against the property.
- D. Are added to the purchase price at the foreclosure sale.

20) When a lender wants to sell a loan to another investor, the borrower may sometimes be asked to verify the loan balance by means of a/an:

- A. Certificate of novation.
- B. Estoppel certificate.
- C. Certificate of reduction.
- D. Verification certification.

21) Elmer signed a contract to buy a new home prior to selling his old one. To raise cash for a down payment, he obtained a/an:

- A. Equity participation loan.
- B. Blanket mortgage.
- C. Shared appreciation loan.
- D. Bridge loan.

22) A bridge loan is similar to a/an:

- A. Equity loan.
- B. Blanket loan.
- C. First mortgage.
- D. Equity sharing loan.

23) A mortgage which covers real estate and personal property is:

- A. Blanket mortgage.
- B. Bridge loan.
- C. Package mortgage.
- D. Reverse annuity loan.

24) In a real estate financing transaction which instrument represents the primary obligation to repay a debt?

- A. Mortgage. C. Promissory deed.
- B. Deed. D. Promissory note.

25) The mortgagor is the:

- A. Borrower.
- B. Broker.
- C. Lender.
- D. Agent of a mortgage broker.

26) An existing mortgage that is included as part of the selling price is which one of the following?

- A. Assumed mortgage.

- B. Blanket mortgage.
- C. Balloon mortgage.
- D. Amortized debt.

27) Which one of the following may be the greatest risk to the mortgagor?

- A. Second mortgage.
- B. FHA.
- C. Blanket mortgage.
- D. First mortgage.

28) When a mortgagee forecloses:

- A. All junior liens are wiped out.
- B. Property taxes are forgiven.
- C. Higher bidder assumes all liens.
- D. Most junior liens are cleared.

29) The mortgage that is subordinate to other mortgages but includes the amount of the other mortgages is what type of mortgage?

- A. Blanket.
- B. Wraparound.
- C. Purchase-money.
- D. Open-end.

30) Mortgagee executed a satisfaction of mortgage in accordance with which clause?

- A. Alienation.
- B. Habendum.
- C. Defeasance.
- D. Exculpatory.

31) Interest charges in excess of the legal rate are known as:

- A. Usury.
- B. Points.
- C. Acceleration.
- D. penalties

CITY PLANNING, ZONING, SUBDIVISION PROPERTY DEVELOPMENT

State and municipal government has the inherent right to regulate and control the private use of land to promote the health, safety, convenience, morals, and general welfare of its citizens. Public regulation of privately owned real estate is implemented by:

PUBLIC CONTROL OF PRIVATE PROPERTY

1. Zoning Laws.
2. Building Codes.
3. Subdivision Control.
4. Environmental Protection Laws.
5. State and Federal Interstate Subdivision Land Sales Acts.

ZONING LAWS: Zoning by-laws or ordinances are established by either town or city government to regulate and control the use of land. Authority to pass zoning laws is conferred upon cities and towns by state statute.

ZONING LAW LIMITATIONS: Although zoning laws might adversely affect the rights of property owners by limiting the use of their land without compensation, zoning laws are considered constitutional, being necessary for the common good. Courts have held zoning regulations to be a **reasonable exercise of government control** if they are clear and specific do not discriminate and apply equally to all property.

Note: A licensee to the prospective buyer must disclose any zoning changes made after a property is listed.

CITY PLANNING: City planning provides for expansion in an orderly and logical fashion in the best interests of all citizens. It also provides for the physical and economic improvement of existing buildings and areas.

State law requires cities to establish **planning boards**, which survey the social and economic, needs of their citizens. Through analysis of the city's economic strengths and weaknesses, the planning board estimates its future needs and growth. As a result of their study, a **master plan** is formulated to direct and encourage the desired growth and development of the city.

LAND USE RESTRICTIONS: Zoning laws restrict use of land in the following ways:

1. Height and bulk of buildings.
2. Lot size requirements.
3. Set back requirements (Minimum distance of improvement to property line.)

Helpful Hints: Factors in designing a master plan.

Whether or not to maintain existing housing or to allow the building of high-rise apartments
Whether to rezone certain areas allowing more or less commercial activity. After public hearings to resolve conflicts, the plan is put to a vote, and if passed, is carried out largely through the use of zoning regulations, building codes and subdivision laws.

4. Population density controls. (Minimum or maximum floor area per living unit.)
5. Parking space requirements.
6. Accessory buildings.
7. Types of buildings and intensity of use.
8. Recreation requirements.

CLASSIFICATION OF LAND USE: The four main zoning classifications are:

- **Residential** - Single family, multi-family, and high rise.
- **Commercial** - Businesses, stores, etc.
- **Industrial** - Light or heavy manufacturing.
- **Agricultural** - Farms.

DIMENSIONAL REQUIREMENTS AND LIMITATIONS: All building structures are subject to height and area limitations. These include lot size, floor area, lot width and minimum yard space (setback) on front, sides, and rear. **Note:** The “setback” is the distance from the street to the front of the house.

AREA OR BULK REGULATIONS: These are principally applicable to residential areas and are intended to regulate the population density to prevent congestion and crowding, to safeguard health standards and to increase the amenities of living. Such regulations usually specify the following:

1. The ratio of land area to building area.
2. Minimum setback of the building from the street, side and rear, lot lines.
3. Minimum frontage required.
4. Height in feet or stories.
5. Setbacks for non-residential structures, such as sheds, garages, swimming pools, etc.
6. Minimum number of square feet of living area.

Typical applications of the above regulations might specify that a single-family home may not use more than 35% or 40% of the total land area and that there must be a minimum of one hundred feet of frontage, or that there must be at least twenty-five feet of rear yard space.

Zoning laws may regulate or determine the height and type of structures in rear yards, the height and location of fences, the amount of landscaped area or open space, parking facilities, and size and location of signs and illumination.

NON-CONFORMING USE: The operation of zoning laws will not affect the use of any building, which was in use at the time of the adoption of the by-law even though the use might be in violation with the zoning change. Thus, a three-family residence in a district, which is rezoned for two family houses only, is considered as a non-conforming use and is exempt from the zoning change. However, if the nonconforming use is abandoned, it may not be reused at a later time. A non-conforming use may not be changed or expanded. **Note:** If a property's current legal use differs from what is allowed by present zoning laws, the use is known as ***nonconforming***.

ENFORCEMENT OF ZONING LAWS

BUILDING PERMIT: Enforcement of zoning laws is carried out by the issuance of building permits. **Note:** An increase in building permits issued in an area may result in an increased demand for residential rental properties. Before any improvement to land or structural changes can be made, a building permit must be obtained from the proper local authority, such as the building department, which examines the proposed plans to determine whether the project meets the zoning laws. **Note:** “Police power” is the authority over zoning ordinances.

BOARD OF APPEALS: In order to safeguard the rights of all citizens and property owners and to prevent unreasonable **zoning laws**, each city or town is required to appoint a board of appeals to which an applicant may appeal the building department's refusal to issue a building permit. After holding a public hearing, the board of appeals may either grant or deny the permit. The board also has the right to grant a **special permit** or to authorize a **variance** from the terms of the zoning law.

ZONING ORDINANCE: A municipal in zoning that is used for regulation in controlling the characteristics and use of property.

MAPS: A survey system used for Maps can be found on page 2-7. The lot-and-block system uses lot and block numbers referred to in a plat map filed in the public records of the county where the land is located.

SPECIAL PERMIT: In many instances, a building requirement or zoning law may allow for exceptions, provided certain requirements or conditions are met by the builder.

VARIANCE: A variance is an **exemption** from the zoning law, which may be granted by the board of appeals to prevent a substantial hardship, provided it, does not cause serious detriment to the public good and does not substantially change the basic character of the neighborhood. The board's refusal to act reasonably and in good faith may justify an appeal by the applicant to the state courts.

Helpful Hints: Spot Zoning

A permit may be granted for the construction of a small convenience store in a residentially zoned neighborhood. However, the courts will strike down a major change, such as the allowance of a noisy factory.

SPOT ZONING: Spot zoning allows a small area of land to be used in a way, which is inconsistent with the zoning law. It is similar to a variance, but usually has more of an impact on the neighborhood.

PLANNED USE DEVELOPMENT (PUD): This is a relatively recent, conditional, permitted use of land, which maximizes the use of open spaces to produce a high density of dwellings. It is also referred to as **cluster zoning** since it allows the grouping of housing units on less-than-normal-house size lots. Rather than build ten units each on two acres of land, a builder may be permitted to build twenty units on one acre and use the other acre for common recreational facilities. PUD

also may allow for the **mixed use** of residential and commercial property in areas where it is not permitted by existing zoning laws.

Helpful Hints: Special Permit

A zoning law might limit the height of buildings in a particular area to seven floors but provide for an exception to increase the height to eight floors if the builder furnishes additional parking spaces.

Helpful Hints: Snob Zoning

A zoning law, which requires an acre of land or two hundred feet of frontage for single-family home construction, would effectively bar low-income families from moving into the area. Such practices are referred to as "**Snob Zoning**" and are considered repugnant to public policy and may be struck down by state courts.

BUFFER ZONE: A buffer zone is a strip of land separating differently zoned areas.

SNOB ZONING - REVIEW BY STATE COURT:

Zoning laws, which limit population density, may indirectly discriminate against persons in a lower economic class or in the construction of low-income housing.

Under the normal procedure it would take years and considerable expense to appeal a zoning board decision to a court of last resort. **The Anti-Snob Law** provides immediate relief by granting an aggrieved person a twenty day right of appeal to a Superior court or to the Land Court. After reviewing the facts, the court may annul any decision of the board if it finds that such decision exceeded its authority. The court will consider

whether the board acted fairly and reasonably or whether the decision was capricious and arbitrary.

DOWNZONING: Downzoning is the rezoning of land from a high-density use (more active use) to a lower-density use (less active use), such as from an apartment house zone to single-family homes.

MARKETABILITY, EFFECT OF ZONING REGULATIONS: Although zoning changes may affect the value of land, they do not make it unmarketable, as would a lien or other encumbrance. On the other hand, a zoning violation would have an adverse effect on a sale. An illegally converted two family houses would sell for less than an approved two-family house.

BROKER'S DUTY TO DISCLOSE ZONING LAWS OR PENDING CHANGES: Because zoning laws are public knowledge, brokers and salesperson are not generally responsible to disclose them to prospective buyers. Disclosure of the zoning laws to a prospective buyer is required if the buyer's contemplated use does not conform to existing zoning regulations. Misrepresenting a permitted zoning use as a buying inducement could be grounds for rescission and possible license sanction.

BUILDING CODES: In addition to satisfying the zoning requirements, repair, alteration, or erection of any structure must meet certain state construction standards known as building codes. The codes set the standards for building materials, structural requirements, sanitary equipment, plumbing, electrical wiring, fire prevention equipment, smoke detectors and exit locations.

SUBDIVISION CONTROL LAW

Subdividing is the division of a tract of land into building lots primarily for home construction. Before being granted a building permit, the subdivision plans must be approved by the local planning board and recorded in the registry of deeds. The purpose of subdivision control is to regulate the planning of home site developments to assure suitable **access** to public ways and to appropriate municipal utilities. The plans must show compliance with requirements for frontage, sewers, streets, water mains, lot dimensions, setback lines, public

use areas, public utility easements, and facilities for fire, police, and street lighting equipment. State and federal approval must also be obtained if the project will substantially affect the environment. A bond must be filed by the builder to assure performance in accordance with the plans.

If the plan does not come within the subdivision control law, the planning board is required to assent to its recording without approval. Most developers obtain **preliminary approval** of their subdivision plans in order to be unaffected by future zoning changes prior to approval of final or **definitive plans**.

ENVIRONMENTAL PROTECTION LAWS

The National Environmental Policy Act (NEPA) of 1969 and the Clean Air Act of 1970 were passed to protect the environment from being harmed as a result of improper development and use of land. They are designed to prevent pollution of the air, inland waters, flood plains, rivers, marshes, lakes, streams, coastal waters, and tidal plains. More recent environmental issues include protection of habitats for wildlife, wetlands, shorelines, and endangered species.

ENVIRONMENTAL IMPACT STATEMENT (EIS): NEPA requires filing an environmental impact statement with the **Environmental Protection Agency (EPA)** prior to changing or initiating a land use or development to ensure that the use will not adversely affect the environment. The EIS must set out all the significant ways the project might have a negative effect on the environment and indicate the steps and precautions to be taken to prevent or minimize such harm. The study must be prepared and paid for by the developer and approved by the proper agencies after public hearings.

INTERSTATE LAND SALES FULL DISCLOSURE ACT

The Interstate Land Sales Full Disclosure Act is a federal statute administered by the Secretary of Housing and Urban Development (HUD), through the Office of Interstate Land Sales Registration. Its purpose is to provide controls against sharp practices and fraudulent promotional schemes often found to occur when land is sold pursuant to deceptive and misleading sales practices over the telephone, through mail advertising and other "sight unseen" techniques.

REGISTRATION REQUIREMENT: For offerings coming within the Act, the developer must file a "Statement of Record" with HUD disclosing certain required information about the nature of the land being offered for sale or lease. Customers must be given a copy of the approved report at least two days prior to the signing of an agreement or a lease. Registration does not apply to the sale of existing houses or sale or lease of lots in subdivisions containing less than one hundred lots.

ANTI-FRAUD PROVISION OF THE ACT: The contract must stipulate that roads, sewers, water, gas or electric service and recreational amenities will be provided or completed by the developer, if such are represented or promised.

Registration and anti-fraud provisions apply if:

1. The sub-division contains one hundred or more lots.
2. The lots are less than twenty acres in size.
3. The sale or lease is for unimproved building sites (land only).

Registration and the anti-fraud provision do not apply:

1. To the sale or lease of cemetery lots.
2. To the sale of existing homes or if the developer agrees to construct a home on the lot within two years after the sale.
3. If an onsite inspection is made by the buyer prior to signing a contract.

Only the anti-fraud provisions apply to the sale or lease of lots in subdivisions containing over twenty-four, but less than one hundred, lots. Projects containing fewer than twenty-five lots are not subject to the act.

PRIVATE LAND USE CONTROL - DEED RESTRICTIONS

Deed restrictions are private agreements or covenants, which affect the use of land in a subdivision. They are included in the buyer's deed and become a public record when recorded. They are not liens since they affect the use of land rather than the title. Deed restrictions are valid if they are reasonable restraints, and they benefit all the property owners in the subdivision. Although considered encumbrances, deed restrictions may increase property value by maintaining specific standards in a development or subdivision.

Deed restrictions continue for a period of from twenty to thirty years, after which they may be renewed by a majority vote of the landowners. Deed restrictions will prevail over zoning laws even though they may be more restrictive than the zoning law. Deed restrictions, which are against public policy or considered discriminatory are unenforceable.

DECLARATION RESTRICTION: The declaration of a subdivision, Planned Unit Development, condominium, and commercial or industrial park contains private use restrictions. These have the same legal effect as a deed restriction, as the declaration attaches to the rights in the property. A private party cannot, however, extinguish a declaration restriction by agreement or quitclaim deed. The kinds of restrictions found in declarations are much the same as those found in deeds: construction restraints, aesthetics standards, etc. The underlying purpose of restrictions is to preserve the value and quality of the neighborhood, commercial center, or industrial park.

CLUSTERING: Cluster zoning is a type of zoning in which density is determined for an entire area, rather than on a lot-by-lot basis. Within the cluster zone, the developer has greater flexibility in designing and placing structures. The overall density requirement should be met by the developer. Developments in cluster zoning often incorporate open, common areas with park-like settings.

Cluster zoning specifies housing density for an entire area overall. Hence a developer is free to use some space for high-density housing such as apartments or garden homes. The other space can be used for low-density estate-sized lots. Cluster zoning is a type of smart zoning which is in contrast with traditional zoning ordinances that specify the same density for each and every lot within an area.

Cluster zoning permits residential properties to be clustered closely together than normally allowed. This leaves substantial land area to be devoted to open space. This is also referred to as density zoning.

CONDOMINIUM RULES & REGULATIONS: The condominium laws passed in all states require that a registered land surveyor prepare a plat map that shows the elevations of floor and ceiling surfaces and the vertical boundaries of each unit with reference to an official **datum (point, line or surface from which elevations are measured or indicated)**. An example would be a unit's floor might be 60 feet above the datum and its ceiling, 69 feet. In this case a separate plat is prepared for each floor in the condominium building.

NEIGHBORHOOD ASSOCIATIONS: (NA) is a group of residents or property owners who advocate for or organize activities within a neighborhood. An association may have elected leaders and voluntary dues. The term neighborhood association is sometimes incorrectly used instead of homeowner's association (HOA). But neighborhood associations are not homeowners' associations (HOA). An HOA is a group of property owners with the legal authority to enforce rules and regulations that focus on restrictions and building and safety issues. On the other hand, a neighborhood association is a group of neighbors and business owners who work together for changes and improvements such as neighborhood safety, beautification, and social activities. They reinforce rules and regulations through education, peer pressure and by looking out for each other. Some key differences include:

HOA membership is mandatory generally through rules tied to the ownership of property like deed restrictions. Neighborhood association membership is voluntary or informal.

HOAs often own and maintain common property, such as recreational facilities, parks, and roads, whereas neighborhood associations are focused. Neighborhood associations are more likely to be formed in older, established neighborhoods, especially those that predate HOAs. HOAs are generally established at the time a residential neighborhood is built and sold. Sometimes older established neighborhoods form an HOA to help regulate rules and standards. You can learn more about HOAs at this national resource. In some cases, neighborhood associations exist simultaneously with HOAs, and each may not encompass identical boundaries. For instance, a newer infill neighborhoods-built decades after the original, surrounding HOA-fewer neighborhoods may have its own HOA but also be within the boundaries of a NA.

POLICE POWERS

The states' police power is their inherent authority to create regulations needed to protect the public health, safety, and welfare. Through enabling acts, state delegate to countries and local municipalities the authority to enact ordinances in keeping with general laws. The increasing demands placed on finite natural resources have made it necessary for cities, towns, and villages to increase their limitations on the private use of real estate. There are now controls over noised, air, and water pollution as well as population density.

URBAN DEVELOPMENT

ECONOMIC BASE: An urban area grows and expands because of the growth of its economic base, which is the ability of an area to produce and export goods and services in return for money or income to the community. An economic base provides employment and income, which are vital to a healthy and expanding local economy. As the economic base expands, the population increases, resulting in the need for more homes, service activities and industries.

URBAN DEVELOPMENT PATTERNS: An urban area may develop in one of two ways. The growth may be either outward or upward. During the last thirty years, growth of cities has developed outward along the path of least economic resistance, i.e., growth has been in the direction of the lowest cost of land. Land in non-urban sites has been constantly converted into productive urban space such as shopping centers, industrial plants, or office space in previously open fields. Huge subdivisions of new home construction occur at the fringe, thus increasing the outward growth.

URBAN DEVELOPMENT THEORIES: There are four major theories, which attempt to explain the development of urban areas in the last fifty years. They are:

1. **Concentric Theory:** Land uses tend to develop in a definite pattern of concentric circles outward from a central point, known as the central business district.
2. **Axial Theory:** Land uses tend to develop along major streets, highways, and public transportation lines outward from the central business district.
3. **Sector Theory:** Land uses tend to develop along more efficient arteries, rather than newer or less efficient corridors.
4. **Multiple Nuclei Theory:** This theory assumes that there is more than one business district in a given area and that land use patterns develop outward from these various centers of activity.

EMERGING PATTERNS OF URBAN LAND USE: The decentralization of American cities following World War II and the popularity of urban shopping centers has produced satellite or "bedroom" communities. Their residents work in the cities and raise their families in the suburbs. Through proper city planning, many of these dormitory communities have developed their own economic base and have merged to form a larger configuration, known as a megalopolis. However, another pattern is emerging. Inflation, higher building costs, shortage of land and increased energy costs are beginning to result in a shift back to centralization of homes and commerce resulting in an upward growth. Planned communities with high rise office and apartment buildings, condominiums and cluster housing may be the pattern of the future.

KEY WORDS AND PHRASES

Buffer zone	Building code	Building permit	City planning	Clustering
Deed restriction	Declaration restriction	Developer	Down zoning	Environmental Impact
Statement (EIS)	Interstate land sales	Full disclosure act	Land use control	Master plan
Neighborhood associations	Nonconforming use	Planned use development	Setback	Special permit
Spot zoning	Subdivision	Urban development	Urban land use	Variance
Zoning laws	Zoning ordinances			

Multiple Choice Questions

1) Zoning controls do not affect which of the following?

- A. Use of land.
- B. Population density.
- C. Height of property.
- D. Rental rates on property.

2) When a small area of land in an existing neighborhood is rezoned, this is known as:

- A. Down zoning.
- B. Spot zoning.
- C. Conditional zoning.
- D. A zoning variance.

3) The effect of a proposed development on a community is determined by the preparation of:

- A. A property disclosure report.
- B. An environmental impact statements.
- C. A prospectus.
- D. The community's master plan.

4) Which of the following are private means of regulating land use?

- A. Zoning ordinances.
- B. Restrictive covenants.
- C. Health codes.
- D. Building codes.

5) A use not in compliance with present zoning, but legal when it was enacted is called a (an):

- A. Variance.
- B. Nonconforming use.
- C. Spot zoning.
- D. Encroachment.

6) Applied to land use, zoning laws may do all of the following EXCEPT:

- A. Encourage uniformity in land use.
- B. Set lot size requirements.
- C. Determine location of buildings on lots.
- D. Set building construction standards.

7) An owner intends to build a six-foot fence around his property line. He would first check:

- A. Building codes.
- B. Zoning restrictions.
- C. Deed restrictions.

- D. All of the above.

8) A building plan does not comply with the setback requirements. The owners need to request a:

- A. Variance.
- B. Special permit.
- C. Waiver.
- D. Zoning change.

9) Mr. Black is looking for acreage to develop into a residential subdivision. The broker shows Mr. Black an attractive parcel at the edge of town that is currently zoned for agricultural use but looks ripe for development. Of the following choices, which would be the most rational for Mr. Black?

- A. Make an extremely low offer to protect himself in case the zoning cannot be changed.
- B. Pay the asking price and hope for the best.
- C. File for a zoning change, and if approved, offer to buy the property.
- D. Make an offer with a contingency that zoning be changed to residential before closing.

10) Which of the following is not limited by zoning regulations?

- A. Height of buildings.
- B. Population density.
- C. Maximum rents.
- D. Use of buildings.

11) To increase open space and conserve land, a developer will group housing units by:

- A. Deed restrictions.
- B. Placing cul de sacs in the plot.
- C. Clustering.
- D. Building apartments.

12) A subdivider wants to limit the height of trees so as to preserve views. This could most likely be done with a:

- A. Zoning amendment.
- B. Conditional use permit.
- C. Buffer zone.
- D. Deed restriction.

13) Future uses of land within a community may be regulated by all of the following EXCEPT:

- A. Deed restrictions.
- B. Zoning laws.
- C. Subdivision regulations.
- D. Building codes.

14) All of the following are established by the private sector EXCEPT:

- A. Building styles.
- B. Restrictive covenants.
- C. Subdivision plans.
- D. Building codes.

15) An environmental impact statement will not reveal the effect of a planned development on:

- A. Air quality.
- B. Automobile traffic.
- C. The water table.
- D. School enrollment.

16) A broker lists a three-story home in an area zoned for single-family residences. The third floor contains a two-bedroom apartment with kitchen and bath but has only one means of access. The owner says the apartment was there when he took title and is currently rented. Under these circumstances, the broker should:

- A. Refuse the listing on this point alone.
- B. Refuse the listing until talking to the building department.
- C. Take the listing and say nothing about the apartment.
- D. Take the listing but advise prospects of the possible zoning violation.

17) A landowner who is denied a proposed development of his land by the community's planning authorities:

- A. Can force the community to purchase the land under eminent domain.
- B. Will receive payment for the loss in the land's value.
- C. May appeal the decision to the courts.
- D. May sue the planning board.

18) A municipal requirement specifies that no permanent improvement may be built within ten feet of a property sideline. Such a requirement is called a/an:

- A. Spot zone.
- B. Setback.
- C. Exclusionary zone.
- D. Nonconforming use.

19) Legal authorization to move into a dwelling unit upon its completion and meeting of all local requirements is called a/an:

- A. Variance.
- B. Occupancy agreement.
- C. Building permit.
- D. Certificate of occupancy.

20) An exercise of police power which attempts to establish guidelines for a community's development is called:

- A. Planned unit development.
- B. Zoning.
- C. A building ordinance.
- D. Planning.

21) The Federal Interstate Land Full Disclosure Act requires registration:

- A. For sales of fifty or more lots.
- B. For sales of one hundred or more lots.
- C. For all out-of-state land sales.
- D. For cemetery lots.

22) The anti-fraud provision of the Interstate Land Sales Full Disclosure Act applies to:

- A. All sales of out-of-state lots.

- B. Sales of lots in subdivisions containing fewer than twenty-five lots.
- C. Sales of lots in subdivisions containing thirty lots.
- D. Sales of lots in subdivisions containing one hundred or more lots.

23) A Florida land developer has completed the construction of sixty homes and is offering them for sale in Massachusetts. The developer:

- A. Must register the development.
- B. Must file a "Statement of Record" with HUD.
- C. Must comply with Massachusetts out-of-state land sales law.
- D. Is exempt from state and federal regulation.

PROPERTY MANAGEMENT

The property manager's task is: (1) to produce the highest possible profit for the owner, (2) to protect the owner's interest and (3) to free the owner of the burden of operation of the property. A great degree of skill is required on the part of the manager in advertising, showing, and selecting tenants. The property manager must have a thorough understanding of leases, tenancy agreements and other legal documents involved in the operation of income property. Property management involves the leasing; managing, marketing, and overall maintenance of real estate owned by others, usually rental property and must take responsibility for maintaining the owner's investment and making sure the property earns income. The property manager must also see to it that the property is kept well maintained, repair work is done promptly, and vital services are provided without interruption.

TYPES OF PROPERTIES REQUIRING MANAGEMENT

As a specialized field, property management is one of the fastest growing areas of real estate. All types of property, from farms to hotels need efficient management for a smooth and productive operation. The most common types of properties requiring full or part time management are office and industrial buildings, store properties and residential buildings. Management may involve a single building or a complex, such as an industrial park or a shopping center.

TYPES OF MANAGERS

Many mortgage lenders require that investors hire a professional property manager to manage their properties. Property managers vary from the large firm specializing only in property management, to the small office, which manages a few properties as part of its brokerage operation. A **building manager** is employed by a firm or an owner to oversee the management of a single building. A **resident manager** is a building manager who lives in the building. Building and resident managers are usually paid a straight salary. A management company is compensated on a fee basis depending upon the gross rents and the number of rental units.

GOALS OF THE PROPERTY MANAGER

Some of the goals the property manager is to follow:

1. **The physical property must be maintained in good condition.**
2. **Responsible for budgeting and controlling expenses.**
3. **Keep proper accounts and,**
4. **Making periodic reports to the owner**

Some property managers work for property management companies as well in which they or the owner may employ building managers to supervise the daily operations of a building. In

some cases, these individuals might be residents of the building.

FUNCTIONS OF PROPERTY MANAGERS

The functions of the property manager are to:

1. **Secure tenants and lease space.**
2. **Collect rents and keep records.**
3. **Achieve the goals of the owners.**
4. **Maintain the property and preserve value of the property.**
5. **Hire and fire on-site personnel.**
6. **Generate income for the owners.**
7. **Keep the premises properly insured.**
8. **Keep proper records and render periodic reports.**

LICENSE REQUIREMENT FOR PROPERTY MANAGERS

Property managers and their regular employees, while acting under a management contract, are not required to be licensed. However, a property manager who receives an additional fee or commission for selling the owner's building is required to have a real estate broker's license.

Note: In most states, licensed real estate brokers are permitted to manage properties for others and in cases where separate property managers must be licensed. However, when employed by the owner, non-licensed individuals are permitted by some states to manage properties. While some states require licensing in order to manage condominium or cooperative homeowner's association, others do not. Some states require an on-site manager for residential income-producing properties having more than a certain number of units.

RENTALS AND LEASES

In order to effectively market space, the property manager must establish a rental schedule and attract prospective tenants. Before entering the market, the property manager must make a thorough analysis of the property involved to assess its values objectively. In addition, most states have landlord-tenant laws that require the landlord-owner to keep the property repaired and make sure it complies with building codes. It is important to have an accurate knowledge of such matters as the character of the neighborhood, the advantages, and disadvantages of the location of the property, the character of competing space in the neighborhood, rents currently charged for similar space and the nature of potential demand.

Since rental prices are usually established by supply and demand, most rental schedules can be established on a market comparison basis. The manager compares his or her units to other units renting in the same area and adjusts his or her rents up or down to compensate for the differences in age and modernity of the apartments. As a rule, rents should be adjusted for an optimal 95% occupancy. Rents should be raised for fully occupied type of units and lowered for units with less demand.

Since the purpose of renting is to provide a reasonable return on the owner's investment, the rents must be high enough to provide a gross return, which will net the owner a profit after

deducting expenses and management costs. Due to high demand specialist are needed to manage shopping centers, commercial buildings, and industrial parks in addition to the more visible management of residential properties.

ATTRACTING AND SECURING TENANTS

This is one of the most vital functions of a property manager. A smooth-running building with all rents paid on time and a minimum of complaints and vacancies can only be achieved through the proper selection of tenants. The property manager must find tenants whose specific needs and requirements match the service opportunities that the property has to offer. Advertising should describe the apartment fairly and accurately. Overstating the condition or desirability of the apartments will result in wasted time and effort and unhappy tenants.

The most important criterion for selecting tenants is the tenant's capacity and habit of paying rent. This can be determined by checking work or business references, the previous landlords, and through credit reports relating to outstanding notes, mortgages, judgments, or other debts. Many rental agents insist that the prospective tenant leave a deposit equal to one month's rent with their application for the apartment, pending a credit investigation. A person's inability to make such a deposit might be an indication of a problem in making future rent payments on time.

COLLECTING RENTS

A rental collection policy should be established to assure that all tenants pay regularly and promptly. Tenants should be impressed with the importance of paying their rent on time. A procedure of follow up of past-due rentals should be rigidly and uniformly adhered to. Within five to ten days after the rental due date, a statement for past-due rents should be sent to delinquent tenants. A week or ten days later, a final notice should be sent. If the notices are ignored, legal proceedings should be considered in order to obtain possession of the premises or to collect the unpaid rent.

CONDOMINIUM & ASSOCIATION MANAGEMENT

As part of the important regulations that assures the proper role of managers in condominiums, homeowners today have placed new demands on property managers with complex and development codes they must follow by. The property manager must assist in providing a comprehensive array of services to volunteer boards. Many states now require at least a real estate license or an association management license for those who specialize in managing associations.

REPAIRS AND MAINTENANCE

The property must be given constant care and attention in order that the owner's investment may yield the highest possible net return over its economic life. Tenants will be happier and there will be less turnover when the building is kept clean and attractive and in good repair. A regular schedule of inspections and maintenance must be maintained. Some of

the key factors in building maintenance are as follows:

1. All complaints must be answered promptly.
2. Buildings should be kept clean and attractive.
3. Frequent inspections should be made.
4. Halls should be lighted, and elevators should be in good working order.
5. The superintendent should be checked for proper performance.
6. Heating systems and service utilities should be kept in proper order.
7. Conditions of the sidewalks, stairs, flooring, roofing, wiring, and plumbing should be constantly checked for safety.

Deferred maintenance or failure to undertake preventative maintenance can lead to major problems, often involving emergency repairs at inconvenient times.

REPAIR EXPENDITURES

The property manager may refer work to a general contractor or deal directly with suppliers and workers. Better service usually results when the workers are under the direct control of the manager, who may be a little more prudent about the purchase of materials than a general contractor. The property owner is billed for actual expenditures plus a nominal overhead service charge of five or ten percent for job superintendence.

MAINTAINING PROPER RECORDS AND RENDERING PERIODIC REPORTS

The property manager must maintain an adequate system of accounts and make regular monthly reports to the owner. A detailed annual report for purposes of cost accounting must be made annually in order for the manager and the owner to review the fluctuations of income and expenses, and to predicate, thereon, future decisions with respect to rentals, maintenance, and productivity of the property as an investment. The property manager may also submit an "**after tax**" cash flow analysis at year's end.

HOUSING FOR THE ELDERLY

Besides the assistance to many areas of management, there are special requirements that are grouped with the managing of an elderly project or housing programs. The near-elderly (55+) and elderly (62+), that require management in their housing facility must have property managers that are responsible for the operations of the facility, as well as housekeeping, meal service, social event planning, and medical emergency planning. However, since subsidized housing is involved, these property managers need to be familiar with state and federal rules pertaining to the eligibility requirements.

FEDERAL LAWS AFFECTING PROPERTY MANAGERS

There are several laws affecting the ability to act as a property manager. One is "**The Americans with Disabilities Act**". The Title III of the ADA prohibits discrimination in commercial properties and public accommodations. The ADA requires that managers ensure

that people with disabilities have full and equal access to facilities and services. An example of this would be a manager that prepares a lease contract that is enlarged and easy to read. Alternative method would be to install a device lower on a wall that is reachable for a person on a wheelchair.

THE EQUAL CREDIT OPPORTUNITY ACT

This prohibits a lender for denying a loan based on a person's race, color religion, national origin, sex, marital status, age, and receipt of public assistance. The property manager should use the same lease application for every applicant. If a manager requires a credit report from one applicant, the manager should require credit reports from all applicants. There should be consistency in evaluating the income and debt of applicants and in determining whether to rent to an applicant.

FAIR HOUSING ACT

The federal Fair Housing Act prohibits discrimination in the sale, rental, or financing of housing based on race, color, religion, national origin, sex, familial status, or disability. (See Chapter 12) Property managers need to ensure that their practices of attracting tenants do not violate fair housing laws.

RISK MANAGEMENT

One of the most important responsibilities of a property manager is to protect the owner from monetary losses resulting from unsafe property conditions, fires, and other hazards. Recognizing potential perils and taking proper action to prevent or minimize a loss is known as **risk management**. Potential areas of loss can be dealt with in various ways. The risk may be **avoided** by eliminating it, or controlled by safety precautions such as installing sprinklers, fire doors and smoke detectors. Some of the risk may be retained by insuring with large deductibles. Major risks, such as fire and liability are best managed by **transferring the risks to an insurance company, i.e., buying insurance**.

VARIOUS TYPES OF INSURANCE FOR COMMERCIAL PROPERTY

There are three major areas of risk which must be insured against: (1) fire and related hazards, (2) personal injury claims and (3) claims by employees injured on the job. The three types of policies to cover these risks are: (1) fire and hazard insurance, (2) liability insurance and (3) worker's compensation insurance. Optional policies may be obtained to cover low risk activities.

FIRE OR HAZARD INSURANCE: Hazard insurance pays for losses resulting from fire, windstorm, explosion, hail, smoke damage and civil insurrection. The amount paid for losses is determined in one of two ways: (1) The actual cash value or replacement cost less depreciation or (2) the replacement cost.

Helpful Hints: Insurance Coverage

A building, which has a replacement value of \$600,000, is damaged by fire, and the estimated cost of repairs is \$400,000. If the building owner had carried \$480,000 of insurance, the full amount of the claim would be paid. If the owner carried less than the 80% required, the loss would be prorated between the insurer and the owner. If the building were only 60% insured at the time of the loss, the insurance company would pay only \$300,000, i.e., $60\% \div 80\% = 75\% \times \$400,000 = \$300,000$. In any event, the insurer will pay no more than the face value of the policy.

Most commercial policies contain a "**co-insurance**" clause, which requires that the property be insured to at least 80% of its replacement value at the time of the loss, in which case the insurer will pay for the actual replacement cost of the damaged portion of the property up to the face amount of the policy. If the coverage is less than 80% at the time of the loss, the insurer pays only a percentage of the loss, and the owner becomes a "co-insurer" for the balance. Most mortgages contain a covenant requiring the owner to carry sufficient fire or hazard insurance to protect the lender in case of loss.

LIABILITY INSURANCE: Liability insurance protects the owner against claims for personal injury and property damage resulting from the owner's negligence or failure to correct unsafe conditions. The owner is responsible for the safety of tenants and their guests in the public areas such as walkways, entrances, halls, and stairwells. The owner is not responsible for injuries occurring in the tenants' rental units unless the injuries were caused by the owner's failure to maintain the rental unit in a safe and habitable condition.

WORKER'S COMPENSATION INSURANCE: State law requires employers to carry worker's compensation insurance to pay for the medical or hospital payments resulting from injuries sustained by employees while in the course of their employment. Although the building owner is not liable for injuries sustained by an independent contractor, the owner could be held liable for injuries sustained by employees of the **independent contractor**. To avoid such risk, the manager should require all independent contractors to submit proof that they have worker's compensation insurance prior to beginning any job.

OPTIONAL INSURANCE: The owner may wish to carry **casualty insurance** for theft, burglary, plate glass breakage, elevator accident, steam boiler, machinery, and loss to the building contents. **Business Interruption** insurance compensates the owner for loss of rent due to damage or destruction of the building. **Increased Cost of Construction** endorsement, although expensive, is advisable for older buildings. It covers the cost of repairing a building after a loss to comply with the latest safety and fire codes. A **demolition cost** rider covers the cost of **demolishing** only the **undamaged** portion of a building caused by a loss to comply with state or local law regulating repairs or construction of buildings.

SUBROGATION: Subrogation gives an insurance company the right to pursue a claim, which the owner (insured) would have against a third party who caused the loss.

Helpful Hints: Subrogation

A building is damaged by a fire resulting from a tenant's careless disposal of a lighted cigarette. The insurance company has the right under subrogation to hold the tenant responsible for the amount the insurer paid to the owner for the loss. Tenants should be informed of this potential liability and be advised to carry appropriate insurance for their protection.

PRIVATE DWELLING INSURANCE

HOMEOWNER'S INSURANCE: Homeowner's insurance is a package policy, which provides residential property owner coverage for fire losses and personal liability claims. The policy insures holders against damage to their property by fire or windstorm, injury to others that occurs on the premises, and theft of, or damage to personal property on or off the premises. The liability coverage includes injuries to others resulting from the owner's negligence and physical damage to property of others caused by the insured. Homeowner's insurance policies contain an 80% co-insurance clause.

THE MANAGEMENT CONTRACT

The management contract may vary depending upon the responsibilities assumed by the manager. In most cases, the contract provides for the manager to rent the units, collect the rents maintain the property and pay for normal operating expenditures out of receipts. The following items should be covered by a management contract:

1. Identification of the names of the parties to the contract.
2. Complete description of the property to be managed.
3. Term of contract, effective and termination dates.
4. Compensation clause and agreement to reimburse agent if collections are insufficient to meet operating costs.
5. Statement of authority of agent to assume charge of building employees, building operation, relations with tenants, and expenditures.
6. Statement of powers and authority of agent to execute leases, collect rent, terminate tenancies, return security deposits, evict tenants and bring legal actions.
7. Maximum to be spent for expenditures without having to notify owner.
8. Limitations of rights to contract for utility services, rubbish removal and window cleaning.
9. Authority to hire and fire personnel.
10. Amount allotted for advertising budget.
11. Clarification of the responsibilities for payroll, insurance, purchasing, building expenses, advertising, and commissions to leasing agents.

ENVIRONMENTAL ISSUES

There are many concerns that a property manager must take in consideration to environmental issues. One being waste disposal to air quality, and another is the knowledge of buildings constructed before 1978 in which lead paint disclosure forms are given to all new tenants. Tenants concerns, as well as federal, state, and local regulations, determine the extent of the manager's environmental responsibilities.

Air quality issues are a key concern for those involved in property management and design. Some examples are associated illnesses that occur that are clinically diagnosed conditions that can be attributed directly to airborne building contaminants. Some symptoms include asthma, hypersensitivity, and some allergies. Sick building syndrome (SBS) is more typical in an office building, and symptoms include fatigue, allergies, dizziness, headache, and sensitivity to odors.

MANAGEMENT FEES

Helpful Hints:
Management Fees

A 20-unit building grosses \$36,500. The manager receives an annual fee of \$125 per unit or \$2,500 plus a percentage of the gross rents. The percentage rate is determined by dividing the unit fee by the effective gross rents (gross rents less vacancy allowance). Allowing \$1,825 for values, the effective gross rent is \$34,675. $\$2,500 \div \$34,675 = 7\% \times \$36,500 = \$2,555$ plus \$2,500 = \$5,055 total annual management fee.

The management fee may be a flat amount, or it may be combined with a percentage of the gross rents.

KEY WORDS AND PHRASES

Building manager	Casualty insurance	Co-insurance	Environmental issues
Expenditures	Fire or hazard insurance	Functions of property managers	Homeowner's insurance
Liability insurance	Management contract	Management fees	Rent collections
Residential manager	Risk management	Subrogation	Worker's compensation insurance

Multiple Choice Questions

- 1) Which of the following tasks would **not** usually be performed by an apartment building manager?
- Collection of rents.
 - Supervision of repair and upkeep of building and grounds.
 - Making mortgage payments.
 - Rental of apartments.
- 2) A property manager may be compensated by all of the following EXCEPT a:
- Percentage of gross rent.
 - Fee for supervising repairs.
 - Leasing fee.
 - Rebate from suppliers.
- 3) A property manager is violating his/her fiduciary responsibility by:
- Informing the owner of market rent changes.
 - Paying bills as per owner's instructions.
 - Performing preventive maintenance.
 - Depositing security deposits in his or her business account.
- 4) A homeowner's insurance policy will protect the premises against all of the following EXCEPT:
- Public liability.
 - Damage to household goods.
 - Flood damage.
 - Theft of personal property.
- 5) A mortgagee will usually require the mortgagor to carry which of the following insurance coverages?
- Fire and extended coverage.
 - Personal property coverage.
 - Medical payments.
 - Personal liability.
- 6) A homeowner's policy which meets the 80% co-insurance requirement would, in the event of loss, pay:
- Actual cash value of the loss.
 - Less than actual cash value of the loss.
 - Replacement cost less depreciation.
 - Full replacement cost up to the face amount of the policy.
- 7) All of the following would be included in a typical manager's operating budget EXCEPT:
- Roof repairs.
 - Decorating and painting.
 - The manager's salary.
 - Cleaning supplies.
- 8) Mr. Brown has a home, which would cost \$120,000 to replace. He carries \$90,000 in insurance. A fire causes damage that will cost \$40,000 to repair. Applying the 80% co-insurance calculation, how much would he receive to repair the damage?
- \$40,000.
 - \$37,500.
 - \$32,000.
 - \$30,000.
- 9) Which type of insurance would cover an apartment building owner for the medical expenses of a tenant who was injured as the result of a fall on a defective staircase?
- Worker's Compensation.
 - Liability.
 - Casualty.
 - Fire and Hazard.
- 10) Rents should be determined by:
- An owner's association.
 - A tenant's organization.
 - Market comparison.
 - Vacancy rate.
- 11) The property manager's responsibilities include which of the following?
- Selecting and retaining tenants.
 - Advertising only when the building becomes 15% vacant.
 - Keeping an accurate account of his/her own salary.
 - Making the owner's mortgage payments.
- 12) A property manager's fee may be based on all of the following EXCEPT:
- Gross rents less expenditures.

- B. A percentage of the gross rents.
- C. A flat fee per unit.
- D. A combination of flat fee plus a percentage of the gross rents.

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