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FOREWORD

The purpose of this book is two-fold: First, it will help to assist the reader in obtaining a real estate license, and secondly, it will provide the basic knowledge of real estate principles and practices necessary to become a successful real estate professional.

For the most part, the text covers the "general" practice of real estate such as the principles and practices which are applicable in all states. Customs and laws which differ from the "general" practice or may be peculiar to Rhode Island are appropriately indicated in each chapter. In addition, Chapter 14 is completely devoted to the Rhode Island real estate licensing laws and other topics relating to Rhode Island. While the information in the chapters are powerful tools in the field of study, all of it may not be necessarily found on the state exam. We do recommend that the students read all the chapters and become fluent with the subject matter.

Each chapter contains a list of key words and phrases and a self-evaluating quiz. The key words will assist the reader in organizing a study plan in preparation for the state license examination. The importance of doing the chapter quizzes cannot be over-emphasized. The quizzes not only gauge the reader's progress in understanding the subject matter, but they also expose the reader to the form and type of questions, which are likely to appear on the state examination. Also, we recommend as well to all our students to focus primarily on the (Note) alerts pointed out and illustrated in most chapters as a key study to knowing the material in preparation for the state exam. The Glossary and Index are the result of a great deal of effort and research. They provide the reader with a concise definition of the various terminologies used in this book as well as a page reference to where the material is located.

As with any text, this book is not intended to be the sole source of material in preparation for entering the real estate business. The reader is encouraged to consult other publications as well as professionals and experts in the field. The student should select a course of instruction, which stimulates a desire to learn and brings additional material into the classroom to supplement the text.
Chapter 1 – The Nature of Real Property

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 is usability is determined by habitability and productiveness. Our planet is made up of, roughly, ¾ open water and ¼ 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.
Chapter 1 – The Nature of Real Property

**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.

**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.

- **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.

- **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):

- **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....).
Chapter 1 – The Nature of Real Property

**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 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?

- **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?

**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, APPURTEANCES, 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.
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.

**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 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 right of lateral support which ensures that the stability received from an adjacent property will not be removed or destroyed.

**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.
- 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.
- 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.
**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**

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<th>Accession</th>
<th>Capture</th>
<th>Feudal System</th>
<th>Littoral</th>
<th>Severance</th>
</tr>
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**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 COMMISSION: 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.

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. Alodial.
   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. Immobile.
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.
Chapter 4 – Estates in Land

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.

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.

- **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 sevemalty 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.

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.

**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.**
**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.

**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.

**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 of 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.

**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.
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

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### RELATED WEB SITES:

**EMINENT DOMAIN:**
WWW.REALTOR.ORG/REALTOR.ORG.NSF/PAGES/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.

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**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.*
mortality 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 INSTRUMENTS

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.

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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
Chapter 8 – Mortgages

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

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

o 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.

**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.

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 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.

**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

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.
**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.

*Page 8-15 explains the 2 systems on fixed disbursement plans.*
**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

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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.

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.

18) The party that is obligated to a debt secured by a mortgage is the:
A. Mortgagor. C. Mortgagee.

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.

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
KEY TERMS TO KNOW FOR THE PEARSON VUE EXAM

- Acceleration Clause
- Agency vs. Subagency
- Appurtenances
- Balloon Payment Mortgage
- Blanket Mortgage
- Blockbusting
- Capitalization of Income
- Commingling of Funds
- Condominium
- Contract “Amendment”
- Cost Approach
- Encroachment
- Equitable Title
- Equity
- Escheat
- Estate at Sufferance
- Estate for Years
- Exclusive Agency
- Exclusive Right to Sell
- Executory Contract
- Fiduciary Relationship
- Financing Contingency
- Fixture (Property Attached to Building)
- Highest and Best Use
- Leasehold Estate
- “Lot and Block” Method of Land Description
- Misrepresentation vs. Fraud
- Multiple Listing Service
- Net Lease
- Nonconforming Use
- Package Mortgage
- Percentage Lease
- Plat
- Preexisting Nonconforming Use
- Redlining
- Severality
- Special Warranty Deed
- Special Assessment Tax
- Specific Performance
- Steering
- Subordination Agreement
- Title Insurance
- Usury
- Variance