

**NOTICE:** These questions must be returned with your answer sheet.  
REAL ESTATE LICENSE SERVICES, 5059 Newport Ave #209, San Diego, California 92107

# Real Estate Practice, Final Exam #1

## FINAL EXAM ANSWER FORM INSTRUCTIONS

The Final Exam Answer Form is the green answer card marked "SCANTRON FORM 882." Before beginning your final exam, fill in your name and student file number on the line marked "NAME" on both sides of the form. Write the date on the "DATE" line.

The Final Exam Answer Form has room for 50 questions on each side. They are numbered 1-50 and 51-100. As you answer the questions on the final exam, make sure that you mark your answers in the appropriate row for each question number.

**USE A NO. 2 PENCIL ONLY.** Using a pencil other than a No. 2 may cause the computer to incorrectly score your final exam. For each answer, choose the best answer and fill in the appropriate box (A-D) on the Answer Form. Fill in the box completely and dark. For example, if your answer on question 37 was "B" you would do the following:

37. [A]  [C]  [D]

If you need to change an answer, make sure that you erase the old answer completely.

1. Whatever is not real property is:
  - A. Personal property
  - B. Fixtures
  - C. Nonexistent
  - D. None of the above
2. The law compares a fiduciary relationship to:
  - A. That of a minister to his congregation
  - B. That of a trustee to a beneficiary under a trust
  - C. That of an officer to an enlisted man
  - D. None of the above
3. The neutral third party in a real estate transaction who does not benefit directly from the sale, with whom the documents and advance monies relating to the sale and the loans are deposited, is called:
  - A. A fiduciary agent
  - B. A real estate broker
  - C. An escrow agent
  - D. None of the above
4. Investment in real estate requires the participation of:
  - A. An investor and a mortgage lender
  - B. The user(s) of the property and the government
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
5. The California Fair Employment and Housing Act prohibits:
  - A. The owner of any housing accommodation from discriminating against any person because of the race, color, religion, sex, marital status, national origin, or ancestry of such a person
  - B. The owner from making or causing to be made any written or oral inquiries concerning the race, color, religion, sex, marital status, national origin, or ancestry of any person seeking to purchase, rent or lease any housing accommodation
  - C. Any person from making, printing, or publishing, or causing to be made, printed or published, any notice, statement, or advertisement, with respect to the sale or rental of a housing accommodation that indicates any preference, limitation, or discrimination based on color, religion, sex, marital status, national origin, or ancestry, or an intention to make such preference, limitation, or discrimination
  - D. All of the above
6. In Section 2780 of the California Administrative Code, it states that which of the following is prohibited?
  - A. Refusing or failing to show, rent, sell or finance the purchase of real property to any person because of that person's race, color, sex, religion, ancestry, physical handicap, marital status, or national origin, or because of racial, religious, or ethnic composition of any occupants of the area in which the real property is located
  - B. Refusing for the same reasons as above to provide or volunteer information to any person about real property
  - C. For the same reasons as above, channeling or steering any person away from real property
  - D. All of the above
7. Which of the following is also prohibited under the same code?
  - A. Representing to any person because of his or her race, color, sex, religion, physical handicap, marital status or national origin that real property is not available for inspection, sale, or rental when such property is in fact available
  - B. Processing an application more slowly or otherwise acting to delay, hinder or avoid the sale, rental or financing of the purchase of real property on account of any of the above reasons
  - C. Refusing or failing to cooperate with or refusing or failing to assist another real estate licensee in negotiating the sale, rental, or financing of the purchase of real property because of any of the above reasons
  - D. All of the above
8. A salesperson license candidate must correctly answer at least ( ) of the questions.
  - A. 80%
  - B. 75%
  - C. 70%
  - D. 85%
9. Article 10 of the National Association of Realtors Code of Ethics pertains to:
  - A. Accepting compensation from more than one party in a transaction
  - B. Discrimination
  - C. Denying equal professional services
  - D. Sharing experience with other realtors
10. Most people who own property together but are not married to each other have what kind of ownership?
  - A. Joint tenancy
  - B. Tenancy in common
  - C. Community property
  - D. None of the above
11. Corporations can be fined up to what amount for practicing real estate without a license?
  - A. \$5,000
  - B. \$500
  - C. \$100
  - D. None of the above
12. Section 125.6 of the California Business and Professions Code specifically prohibits discrimination by a state licensee against any person for which of the following reasons?
  - A. Race, color, and sex
  - B. Religion, ancestry, and physical handicap
  - C. Marital status or national origin
  - D. All of the above
13. Which of the following types of estates involves renting rather than owning?
  - A. Leasehold estates
  - B. Freehold estate
  - C. Country estates
  - D. None of the above
14. In relation to the process of appraisal, brokers and salespersons should have a good understanding of:
  - A. The theoretical concepts of value
  - B. The methods by which value may be estimated most accurately
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
15. According to Section 10177(1) of the California Business and Professions Code, the Commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant who has done which of the following?
  - A. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is causing the property to lose value
  - B. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is causing a decline in the quality of the schools
  - C. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is leading to an increase in crime
  - D. All of the above

16. When is a broker entitled to a commission?  
 A. When the buyer completes the transaction  
 B. When he produces a buyer ready, willing, and able to purchase  
 C. When he supplies a likely prospect  
 D. None of the above
17. The statement that "the worth of a lesser valued object tends to be enhanced by association with many similar objects of greater value" is a statement of the principle of:  
 A. Regression C. Contribution  
 B. Progression D. None of the above
18. From 1513 until 1822, California belonged to:  
 A. The King of Spain C. The Governor of Mexico  
 B. The Catholic Church D. None of the above
19. According to the California Fair Employment and Housing Act, "discrimination" means:  
 A. Refusal to sell, rent, or lease housing accommodations  
 B. Refusal to negotiate for the sale, rental or lease of housing accommodations  
 C. Representation that a housing accommodation is not available for inspection, sale, or rental when such housing accommodation is in fact so available  
 D. All of the above
20. What kind of contract allows one person exclusive use of property belonging to someone else?  
 A. A deed B. A lease C. A title D. None of the above
21. After what period of time will property be deeded to the state if it has property taxes owing and it is unredemmed?  
 A. Ten years B. Five years C. Three years D. One year
22. How many states today have statutes governing to some degree the licensing, regulation and conduct of real estate agents?  
 A. All states, but not the District of Columbia  
 B. All states and the District of Columbia  
 C. 48  
 D. None of the above
23. The California Department of Real Estate was created by legislative act in what year?  
 A. 1917 B. 1920 C. 1915 D. 1900
24. Under the Government Survey method, lines running north and south at six mile intervals from the meridian are called:  
 A. Ranges C. Standard parallels  
 B. Township lines D. None of the above
25. In the language of the California Fair Employment and Housing Act, prohibitions against discrimination which are directed to the "owner" of housing accommodations are meant to include:  
 A. The lessee, sublessee, and assignee  
 B. Managing agent, real estate broker or salesman  
 C. Any person having any legal or equitable right of ownership or possession or the right to rent or lease housing accommodations, including the state and any of its political subdivisions and any agency thereof  
 D. All of the above
26. Which of the following is prohibited by the Code of Ethics and Professional Conduct contained in Section 2785 of the California Administrative Code?  
 A. Knowingly make a substantial misrepresentation of likely value of real property for the purpose of acquiring an interest in property for the licensee's own account  
 B. Making an addition to or modification of the terms of an instrument previously signed or initialed by a party to a transaction without the knowledge or consent of the party  
 C. When acting as a listing agent, not presenting to the seller any written offer to purchase, prior to closing of the sale, unless expressly instructed by the seller to do so, or unless the offer is patently frivolous  
 D. All of the above
27. Which of the following is personal property?  
 A. A mailbox after it has been installed  
 B. Cement blocks  
 C. Redwood decking planks after the deck is built  
 D. None of the above
28. Which has had a bearing on the development of property management?  
 A. High rise steel construction C. Both "A" and "B"  
 B. Private automobile transportation D. Neither "A" nor "B"
29. A contract must:  
 A. Be between competent parties  
 B. Be about a lawful object  
 C. Include an exchange of a valuable consideration  
 D. All of the above
30. According to the Business and Professions Code grounds for the revocation or suspension of license includes:  
 A. Acting for more than one party in a transaction without the knowledge or consent of all parties involved  
 B. Commingling with his own money or property the money or other property of others which is received and held by the licensee  
 C. Taking secret or undisclosed compensation  
 D. All of the above
31. The legal effectiveness of a contract may be:  
 A. Valid C. Unenforceable  
 B. Void D. Any of the above
32. Which of the following must be executed if a loan is to be enforceable?  
 A. A mortgage document C. Both "A" and "B"  
 B. A promissory note D. Neither "A" nor "B"
33. An agreement to waive lien rights in favor of a construction loan is called:  
 A. Subordination agreement C. Contractor's agreement  
 B. Priority agreement D. None of the above
34. A person can be presumed to be a partner in a partnership if he has conducted business as though he were a partner. This is called:  
 A. Partnership by omission C. Partnership by proxy  
 B. Partnership by estoppel D. None of the above
35. A lease which was extended after January 1, 1976 and which contained an automatic extension clause printed in the lease is legal only if:  
 A. The tenant prepared the lease  
 B. The clause was printed in 8-point boldface type  
 C. A statement about the clause appeared in 8-point bold face type just above where the lessee signs  
 D. All of the above
36. What does a promissory note usually state?  
 A. The amount of money borrowed C. The rate of interest being charged  
 B. How and when the money will be repaid D. All of the above
37. In which way might a CRA be funded?  
 A. Increased local taxes C. Both "A" and "B"  
 B. Tax-exempt mortgage revenue bonds D. Neither "A" nor "B"
38. A real estate investment trust that distributes 95% of its money to its shareholders has to pay corporate tax on:  
 A. 100% B. 5% C. 50% D. None of the above
39. As used in the Fair Housing Law, "discrimination" means:  
 A. Refusal to sell, rent or lease housing accommodations  
 B. Refusal to negotiate for sale, rental or lease of housing accommodations  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
40. Which type of ownership might a real estate investor have?  
 A. Fee simple C. Joint tenancy  
 B. Tenancy in common D. Any of the above
41. Which of the following would be considered an encumbrance?  
 A. A tax lien C. An easement  
 B. A mortgage D. All of the above
42. Which would be included in a list of "public controls"?  
 A. Zoning restrictions C. Contractor's license law  
 B. Public health codes D. All of the above
43. A broker's license may be suspended or revoked for which of the following?  
 A. Failing to maintain a place of business in California  
 B. Failing to get a branch office license for each branch if he has more than one place of business  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"

44. The nation's first real estate law was passed where?  
 A. Mississippi  
 B. California  
 C. New York  
 D. Illinois
45. Section 125.6 of the California Business and Professions Code specifically prohibits discrimination by a state licensee against any person for which of the following reasons?  
 A. Race, color, and sex  
 B. Religion, ancestry, and physical handicap  
 C. Marital status or national origin  
 D. All of the above
46. Which is a principal purpose of the California Real Estate Law?  
 A. The protection of the general public from harm at the hands of dishonest and incompetent agents  
 B. The protection of the reputation of honest agents against the adverse publicity and public resentment often caused by the unprincipled and unscrupulous who would infiltrate the agent's ranks  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
47. Which of the following might result in suspension or revocation of a real estate license?  
 A. Failing to notify the commissioner if a salesperson is discharged for cause  
 B. Failing to ensure that both buyer and seller receive notice of sales price within one month after completion of the sale  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
48. Which is not a specific duty of the commissioner?  
 A. Settle commission disputes  
 B. Screen license applicants  
 C. Hold formal hearings within the limits of the Administrative Procedures Act  
 D. Investigate nonlicensees conducting business transactions requiring a real estate license
49. Which is a measurement of length commonly used in legal descriptions of property?  
 A. Rod  
 B. Mile  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
50. One square foot equals how many square inches?  
 A. 144  
 B. 155  
 C. 166  
 D. 177
51. One acre equals how many square yards?  
 A. 43,560  
 B. 160  
 C. 4,840  
 D. None of the above
52. How many degrees are in a circle?  
 A. 360  
 B. 245  
 C. 95  
 D. None of the above
53. Which follows true latitude lines?  
 A. Principal meridians  
 B. Base lines  
 C. Prime lines  
 D. None of the above
54. Which of the following is part of closing a real estate transaction?  
 A. Closing the sale  
 B. Legal closing  
 C. Financial closing  
 D. All of the above
55. Intersections of ranges and township lines enclose areas of how many square miles?  
 A. 52  
 B. 36  
 C. 6  
 D. 3
56. A section is how many acres of a township?  
 A. 220  
 B. 640  
 C. 130  
 D. None of the above
57. Concerning management in general, which of the following is true?  
 A. Short term goals tend to displace or supersede long term goals  
 B. Tangible goals tend to win resources over intangible goals  
 C. Easily quantifiable goals will take precedence over less easily quantifiable goals  
 D. All of the above
58. Articles of Incorporation are filed with:  
 A. The Secretary of State  
 B. The Real Estate Commissioner  
 C. The Governor  
 D. None of the above
59. Liability of shareholders in a corporation:  
 A. Is normally limited to the amount of their investment  
 B. Is unlimited  
 C. Depends on whether or not the person is on the board  
 D. None of the above
60. Which of the following can a real estate syndicate do?  
 A. Own real estate in its own name  
 B. Organize ownership firms to own the real estate  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
61. Which of the following does the law recognize as corporations under certain circumstances, even though statutory regulations may not have been met?  
 A. De facto corporation  
 B. Corporation by estoppel  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
62. Which is a responsibility of the Department of Real Estate?  
 A. License and regulate real estate agents  
 B. Regulate the sale or lease of subdivided land  
 C. Govern the handling of real property loans by real estate licensees  
 D. All of the above
63. What is the difference between a joint venture and a general partnership?  
 A. A joint venture is for a single business enterprise  
 B. A joint venture's members have no intention of forming a permanent business relationship  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
64. Which is true of a Real Estate Investment Trust?  
 A. Sells shares to at least 100 people  
 B. Manages property to bring in income  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
65. Which is characteristic of a "joint venture"?  
 A. Unlimited liability  
 B. Tax advantages of a partnership  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
66. Which of the following are legal only if in writing?  
 A. Checks  
 B. Promissory notes  
 C. Bills of exchange  
 D. All of the above
67. In which kind of contract does each side promise something in consideration for the promise of the other?  
 A. Bilateral  
 B. Unilateral  
 C. Trilateral  
 D. None of the above
68. Which is true about signing real estate contracts?  
 A. May include signatures of buyer, seller, spouse, and co-owner  
 B. An agent with proper authority can sign for a principal  
 C. Corporate officers who sign must also affix corporate seal  
 D. All of the above
69. The Statute of Frauds exists to prevent unscrupulous people from taking advantage of others through:  
 A. Dishonest conduct  
 B. Perjury  
 C. Forgery  
 D. All of the above
70. In contracts, when a new obligation is substituted for one which already exists, this is known as:  
 A. Novation  
 B. Assignment  
 C. Substitution  
 D. None of the above
71. Which of the following contracts must be in writing?  
 A. An agreement that cannot be completed within one year from when it is signed  
 B. A promise to pay off another person's debts  
 C. An agreement depending on marriage (except for agreeing to marry)  
 D. All of the above
72. Which of the following is subject to "specific performance"?  
 A. A real estate sales contract  
 B. An option  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
73. Which of the following is not specifically enforceable?  
 A. Personal service  
 B. Illegal acts  
 C. Getting a third party's consent to something  
 D. All of the above

74. Which of the following means to put everything back the way it used to be, as though a contract had never existed?  
 A. Rescission  
 B. Novation  
 C. Assignment  
 D. None of the above
75. Under the law which took effect July 1, 1978, the liquidated damages clause in contracts is considered:  
 A. Invalid  
 B. Valid  
 C. Good for only some contracts  
 D. None of the above
76. What kind of action removes liens from titles?  
 A. Partition action  
 B. Quiet title action  
 C. Declaratory relief action  
 D. None of the above
77. Which is a type of will recognized by California law?  
 A. Noncupative  
 B. Holographic  
 C. Witnessed  
 D. All of the above
78. What kind of action is taken if someone has a lien on property and cannot collect from the owner?  
 A. Foreclosure action  
 B. Partition action  
 C. Declaratory relief action  
 D. None of the above
79. In which of the following ways can the relationship of principal and agent be created?  
 A. By agreement  
 B. By ratification  
 C. By estoppel  
 D. All of the above
80. If someone other than the legal owner takes possession of property without the owner's permission and lives there openly for at least five years, claiming to be the owner and paying property taxes for those five years, that person can become the owner by:  
 A. Adverse possession  
 B. Estoppel  
 C. Unfriendly possession  
 D. None of the above
81. Escrow departments can be found in:  
 A. Title companies  
 B. Savings and loans  
 C. Banks  
 D. All of the above
82. "Improvements in error" and "addition of fixtures" are both examples of ways to acquire property by:  
 A. Accession  
 B. Accretion  
 C. Estoppel  
 D. None of the above
83. When a river dries up or changes course, the addition of land is called:  
 A. Erosion  
 B. Avulsion  
 C. Reliction  
 D. Alluvion
84. When land is torn away, as by an earthquake or tidal wave, this is called:  
 A. Alluvion  
 B. Erosion  
 C. Avulsion  
 D. Reliction
85. What kind of action does the court take when it is asked to decide who actually has title before contending parties can take further action?  
 A. Quiet title action  
 B. Declaratory relief action  
 C. Partition action  
 D. None of the above
86. How do mortgage companies get the money they need to originate loans?  
 A. By borrowing on their line of credit with commercial banks  
 B. By selling short-term debt instruments called "commercial paper"  
 C. Neither "A" nor "B"  
 D. Both "A" and "B"
87. If justice is better served by leaving title with a new owner than by restoring it to a former owner, the courts may transfer title by:  
 A. Equitable estoppel  
 B. Quiet title  
 C. Partition  
 D. None of the above
88. The Civil Code provides that every agent has authority:  
 A. To do everything necessary or proper or usual in the ordinary course of business for effecting the purpose of the agency  
 B. To make representations as to facts involved in the transaction in which the agent is engaged  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
89. Creating an easement by using someone else's property without permission for a long time and on a regular basis is called:  
 A. Prescription  
 B. Proscription  
 C. Abandonment  
 D. None of the above
90. The American Land Title Association was developed for:  
 A. Nonresident lenders  
 B. Local lenders  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
91. In appraisal practice, "fair market value" assumes:  
 A. Buyer and seller are motivated by self-interest  
 B. Buyer and seller are well informed and are acting prudently  
 C. The property is exposed for a reasonable time on the open market  
 D. All of the above
92. Which of the following is based on an examination of the public records?  
 A. Abstract-opinion  
 B. Certificate of title  
 C. Guarantee of title  
 D. All of the above
93. Under the provisions of the Insurance Code of California, each title insurance company organized under the laws of this state must have at least \$500,000 paid-in capital, and must deposit with the Insurance Commissioner a guaranteed fund of:  
 A. \$ 20,000  
 B. \$ 25,000  
 C. \$ 50,000  
 D. \$100,000
94. Which is true of an independent contractor, as opposed to an employee?  
 A. The independent contractor sells final results rather than time  
 B. The independent contractor's methods are not subject to the control of another  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
95. Which is true concerning restrictions on an agent's authority?  
 A. An agency to sell does not carry with it the authority to modify or cancel the contract of sale after it has been made  
 B. A mere agency to sell property ordinarily empowers the agent to find a purchaser but does not authorize the agent to enter into a contract to convey on behalf of the principal  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
96. Constructive eviction refers to:  
 A. Eviction by the landlord  
 B. Right of tenant to abandon premises under certain conditions  
 C. Eviction because of new construction  
 D. None of the above
97. Which are promises to do or not do something?  
 A. Conditions  
 B. Deed restrictions  
 C. Banks  
 D. Covenants
98. The subdivision land law defines a subdivision as how many lots or parcels?  
 A. Twenty or more  
 B. Fifteen or more  
 C. Ten or more  
 D. Five or more
99. Unstable rising prices and excessive money together create:  
 A. Savings  
 B. Recession  
 C. Depression  
 D. Inflation
100. Capitalization rates may be determined by:  
 A. Direct comparison  
 B. Using market and sales data  
 C. Neither "A" nor "B"  
 D. Either "A" or "B"

### NOTICE:

When you complete this exam, these questions must be returned to your monitor with your answer sheet. Both those items must be mailed by your monitor to:

Real Estate License Services  
 5059 Newport Ave. #209  
 San Diego, CA 92107

If you have any questions, please telephone (619) 222-2421.

# Student Final Test

NOTICE: These questions must be returned with your answer sheet.

REAL ESTATE LICENSE SERVICES, 5059 Newport Ave.#209, San Diego, California 92107

## Real Estate Practice, Final Exam #1

### FINAL EXAM ANSWER FORM INSTRUCTIONS

The Final Exam Answer Form is the green answer card marked "SCANTRON FORM 882." Before beginning your final exam, fill in your name and student file number on the line marked "NAME" on both sides of the form. Write the date on the "DATE" line.

The Final Exam Answer Form has room for 50 questions on each side. They are numbered 1-50 and 51-100. As you answer the questions on the final exam, make sure that you mark your answers in the appropriate row for each question number.

**USE A NO. 2 PENCIL ONLY.** Using a pencil other than a No. 2 may cause the computer to incorrectly score your final exam. For each answer, choose the best answer and fill in the appropriate box (A-D) on the Answer Form. Fill in the box completely and dark. For example, if your answer on question 37 was "B" you would do the following:

37. [A]  [C]  [D]

If you need to change an answer, make sure that you erase the old answer completely.

1. Whatever is not real property is:

- A. Personal property  
B. Fixtures  
C. Nonexistent  
D. None of the above

2. The law compares a fiduciary relationship to:

- A. That of a minister to his congregation  
B. That of a trustee to a beneficiary under a trust  
C. That of an officer to an enlisted man  
D. None of the above

3. The neutral third party in a real estate transaction who does not benefit directly from the sale, with whom the documents and advance monies relating to the sale and the loans are deposited, is called:

- A. A fiduciary agent  
B. A real estate broker  
C. An escrow agent  
D. None of the above

4. Investment in real estate requires the participation of:

- A. An investor and a mortgage lender  
B. The user(s) of the property and the government  
C. Both "A" and "B"  
D. Neither "A" nor "B"

5. The California Fair Employment and Housing Act prohibits:

- A. The owner of any housing accommodation from discriminating against any person because of the race, color, religion, sex, marital status, national origin, or ancestry of such a person  
B. The owner from making or causing to be made any written or oral inquiries concerning the race, color, religion, sex, marital status, national origin, or ancestry of any person seeking to purchase, rent or lease any housing accommodation  
C. Any person from making, printing, or publishing, or causing to be made, printed or published, any notice, statement, or advertisement, with respect to the sale or rental of a housing accommodation that indicates any preference, limitation, or discrimination based on color, religion, sex, marital status, national origin, or ancestry, or an intention to make such preference, limitation, or discrimination  
D. All of the above

6. In Section 2780 of the California Administrative Code, it states that which of the following is prohibited?

- A. Refusing or failing to show, rent, sell or finance the purchase of real property to any person because of that person's race, color, sex, religion, ancestry, physical handicap, marital status, or national origin, or because of racial, religious, or ethnic composition of any occupants of the area in which the real property is located  
B. Refusing for the same reasons as above to provide or volunteer information to any person about real property  
C. For the same reasons as above, channeling or steering any person away from real property  
D. All of the above

7. Which of the following is also prohibited under the same code?

- A. Representing to any person because of his or her race, color, sex, religion, physical handicap, marital status or national origin that real property is not available for inspection, sale, or rental when such property is in fact available  
B. Processing an application more slowly or otherwise acting to delay, hinder

or avoid the sale, rental or financing of the purchase of real property on account of any of the above reasons

- C. Refusing or failing to cooperate with or refusing or failing to assist another real estate licensee in negotiating the sale, rental, or financing of the purchase of real property because of any of the above reasons  
D. All of the above

8. A salesperson license candidate must correctly answer at least ( ) of the questions.

- A. 80%  
B. 75%  
C. 70%  
D. 85%

9. Article 10 of the National Association of Realtors Code of Ethics pertains to:

- A. Accepting compensation from more than one party in a transaction  
B. Discrimination  
C. Denying equal professional services  
D. Sharing experience with other realtors

10. Most people who own property together but are not married to each other have what kind of ownership?

- A. Joint tenancy  
B. Tenancy in common  
C. Community property  
D. None of the above

11. Corporations can be fined up to what amount for practicing real estate without a license?

- A. \$5,000  
B. \$500  
C. \$100  
D. None of the above

12. Section 125.6 of the California Business and Professions Code specifically prohibits discrimination by a state licensee against any person for which of the following reasons?

- A. Race, color, and sex  
B. Religion, ancestry, and physical handicap  
C. Marital status or national origin  
D. All of the above

13. Which of the following types of estates involves renting rather than owning?

- A. Leasehold estates  
B. Freehold estate  
C. Country estates  
D. None of the above

14. In relation to the process of appraisal, brokers and salespersons should have a good understanding of:

- A. The theoretical concepts of value  
B. The methods by which value may be estimated most accurately  
C. Both "A" and "B"  
D. Neither "A" nor "B"

15. According to Section 10177(1) of the California Business and Professions Code, the Commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant who has done which of the following?

- A. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is causing the property to lose value  
B. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is causing a decline in the quality of the schools  
C. Solicited the sale of property on the grounds that the entry into the neighborhood of persons of another race is leading to an increase in crime  
D. All of the above

Test Jan 17 1987

- 62 16. When is a broker entitled to a commission?
  - A. When the buyer completes the transaction
  - B. When he produces a buyer ready, willing, and able to purchase
  - C. When he supplies a likely prospect
  - D. None of the above
- 78 17. The statement that "the worth of a lesser valued object tends to be enhanced by association with many similar objects of greater value" is a statement of the principle of:
  - A. Regression
  - B. Progression
  - C. Contribution
  - D. None of the above
- 85 18. From 1513 until 1822, California belonged to:
  - A. The King of Spain
  - B. The Catholic Church
  - C. The Governor of Mexico
  - D. None of the above
- 133 19. According to the California Fair Employment and Housing Act, "discrimination" means:
  - A. Refusal to sell, rent, or lease housing accommodations
  - B. Refusal to negotiate for the sale, rental or lease of housing accommodations
  - C. Representation that a housing accommodation is not available for inspection, sale, or rental when such housing accommodation is in fact so available
  - D. All of the above
- 101 20. What kind of contract allows one person exclusive use of property belonging to someone else?
  - A. A deed
  - B. A lease
  - C. A title
  - D. None of the above
- 53 21. After what period of time will property be deeded to the state if it has property taxes owing and it is unredeemed?
  - A. Ten years
  - B. Five years
  - C. Three years
  - D. One year
- 10 22. How many states today have statutes governing to some degree the licensing, regulation and conduct of real estate agents?
  - A. All states, but not the District of Columbia
  - B. All states and the District of Columbia
  - C. 48
  - D. None of the above
- 10 23. The California Department of Real Estate was created by legislative act in what year?
  - A. 1917
  - B. 1920
  - C. 1915
  - D. 1900
- 20 24. Under the Government Survey method, lines running north and south at six mile intervals from the meridian are called:
  - A. Ranges
  - B. Township lines
  - C. Standard parallels
  - D. None of the above
- 133 25. In the language of the California Fair Employment and Housing Act, prohibitions against discrimination which are directed to the "owner" of housing accommodations are meant to include:
  - A. The lessee, sublessee, and assignee
  - B. Managing agent, real estate broker or salesman
  - C. Any person having any legal or equitable right of ownership or possession or the right to rent or lease housing accommodations, including the state and any of its political subdivisions and any agency thereof
  - D. All of the above
- 139 26. Which of the following is prohibited by the Code of Ethics and Professional Conduct contained in Section 2785 of the California Administrative Code?
  - A. Knowingly make a substantial misrepresentation of likely value of real property for the purpose of acquiring an interest in property for the licensee's own account
  - B. Making an addition to or modification of the terms of an instrument previously signed or initialed by a party to a transaction without the knowledge or consent of the party
  - C. When acting as a listing agent, not presenting to the seller any written offer to purchase, prior to closing of the sale, unless expressly instructed by the seller to do so, or unless the offer is patently frivolous
  - D. All of the above
- 17 27. Which of the following is personal property?
  - A. A mailbox after it has been installed
  - B. Cement blocks
  - C. Redwood decking planks after the deck is built
  - D. None of the above

- 28. Which has had a bearing on the development of property management?
  - A. High rise steel construction
  - B. Private automobile transportation
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
- 29. A contract must:
  - A. Be between competent parties
  - B. Be about a lawful object
  - C. Include an exchange of a valuable consideration
  - D. All of the above
- 30. According to the Business and Professions Code grounds for the revocation or suspension of license includes:
  - A. Acting for more than one party in a transaction without the knowledge or consent of all parties involved
  - B. Commingling with his own money or property the money or other property of others which is received and held by the licensee
  - C. Taking secret or undisclosed compensation
  - D. All of the above
- 31. The legal effectiveness of a contract may be:
  - A. Valid
  - B. Void
  - C. Unenforceable
  - D. Any of the above
- 32. Which of the following must be executed if a loan is to be enforceable?
  - A. A mortgage document
  - B. A promissory note
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
- 33. An agreement to waive lien rights in favor of a construction loan is called:
  - A. Subordination agreement
  - B. Priority agreement
  - C. Contractor's agreement
  - D. None of the above
- 34. A person can be presumed to be a partner in a partnership if he has conducted business as though he were a partner. This is called:
  - A. Partnership by omission
  - B. Partnership by estoppel
  - C. Partnership by proxy
  - D. None of the above
- 35. A lease which was extended after January 1, 1976 and which contained an automatic extension clause printed in the lease is legal only if:
  - A. The tenant prepared the lease
  - B. The clause was printed in 8-point boldface type
  - C. A statement about the clause appeared in 8-point bold face type just above where the lessee signs
  - D. All of the above
- 36. What does a promissory note usually state?
  - A. The amount of money borrowed
  - B. How and when the money will be repaid
  - C. The rate of interest being charged
  - D. All of the above
- 37. In which way might a CRA be funded?
  - A. Increased local taxes
  - B. Tax-exempt mortgage revenue bonds
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
- 38. A real estate investment trust that distributes 95% of its money to its shareholders has to pay corporate tax on:
  - A. 100%
  - B. 5%
  - C. 50%
  - D. None of the above
- 39. As used in the Fair Housing Law, "discrimination" means:
  - A. Refusal to sell, rent or lease housing accommodations
  - B. Refusal to negotiate for sale, rental or lease of housing accommodations
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"
- 40. Which type of ownership might a real estate investor have?
  - A. Fee simple
  - B. Tenancy in common
  - C. Joint tenancy
  - D. Any of the above
- 41. Which of the following would be considered an encumbrance?
  - A. A tax lien
  - B. A mortgage
  - C. An easement
  - D. All of the above
- 42. Which would be included in a list of "public controls"?
  - A. Zoning restrictions
  - B. Public health codes
  - C. Contractor's license law
  - D. All of the above
- 43. A broker's license may be suspended or revoked for which of the following?
  - A. Failing to maintain a place of business in California
  - B. Failing to get a branch office license for each branch if he has more than one place of business
  - C. Both "A" and "B"
  - D. Neither "A" nor "B"

- 10
44. The nation's first real estate law was passed where?  
 A. Mississippi C. New York  
 B. California D. Illinois
45. Section 125.6 of the California Business and Professions Code specifically prohibits discrimination by a state licensee against any person for which of the following reasons?  
 A. Race, color, and sex  
 B. Religion, ancestry, and physical handicap  
 C. Marital status or national origin  
 D. All of the above
- 12
46. Which is a principal purpose of the California Real Estate Law?  
 A. The protection of the general public from harm at the hands of dishonest and incompetent agents  
 B. The protection of the reputation of honest agents against the adverse publicity and public resentment often caused by the unprincipled and unscrupulous who would infiltrate the agent's ranks  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 9
47. Which of the following might result in suspension or revocation of a real estate license?  
 A. Failing to notify the commissioner if a salesperson is discharged for cause  
 B. Failing to ensure that both buyer and seller receive notice of sales price within one month after completion of the sale  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 12
48. Which is not a specific duty of the commissioner?  
 A. Settle commission disputes  
 B. Screen license applicants  
 C. Hold formal hearings within the limits of the Administrative Procedures Act  
 D. Investigate nonlicensees conducting business transactions requiring a real estate license
- 20
49. Which is a measurement of length commonly used in legal descriptions of property?  
 A. Rod C. Both "A" and "B"  
 B. Mile D. Neither "A" nor "B"
- 20
50. One square foot equals how many square inches?  
 A. 144 B. 155 C. 166 D. 177
- 20
51. One acre equals how many square yards?  
 A. 43,560 B. 160 C. 4,840 D. None of the above
- 20
52. How many degrees are in a circle?  
 A. 360 B. 245 C. 95 D. None of the above
- 20
53. Which follows true latitude lines?  
 A. Principal meridians C. Prime lines  
 B. Base lines D. None of the above
- 96
54. Which of the following is part of closing a real estate transaction?  
 A. Closing the sale C. Financial closing  
 B. Legal closing D. All of the above
- 20
55. Intersections of ranges and township lines enclose areas of how many square miles?  
 A. 52 B. 36 C. 6 D. 3
- 21
56. A section is how many acres of a township?  
 A. 220 B. 640 C. 130 D. None of the above
- 166
57. Concerning management in general, which of the following is true?  
 A. Short term goals tend to displace or supersede long term goals  
 B. Tangible goals tend to win resources over intangible goals  
 C. Easily quantifiable goals will take precedence over less easily quantifiable goals  
 D. All of the above
- 32
58. Articles of Incorporation are filed with:  
 A. The Secretary of State C. The Governor  
 B. The Real Estate Commissioner D. None of the above

- 32
59. Liability of shareholders in a corporation:  
 A. Is normally limited to the amount of their investment  
 B. Is unlimited  
 C. Depends on whether or not the person is on the board  
 D. None of the above
- 34
60. Which of the following can a real estate syndicate do?  
 A. Own real estate in its own name  
 B. Organize ownership firms to own the real estate  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 33
61. Which of the following does the law recognize as corporations under certain circumstances, even though statutory regulations may not have been met?  
 A. De facto corporation C. Both "A" and "B"  
 B. Corporation by estoppel D. Neither "A" nor "B"
- 11
62. Which is a responsibility of the Department of Real Estate?  
 A. License and regulate real estate agents  
 B. Regulate the sale or lease of subdivided land  
 C. Govern the handling of real property loans by real estate licensees  
 D. All of the above
- 34
63. What is the difference between a joint venture and a general partnership?  
 A. A joint venture is for a single business enterprise  
 B. A joint venture's members have no intention of forming a permanent business relationship  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 34
64. Which is true of a Real Estate Investment Trust?  
 A. Sells shares to at least 100 people  
 B. Manages property to bring in income  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 34
65. Which is characteristic of a "joint venture?"  
 A. Unlimited liability C. Both "A" and "B"  
 B. Tax advantages of a partnership D. Neither "A" nor "B"
- 43
66. Which of the following are legal only if in writing?  
 A. Checks C. Bills of exchange  
 B. Promissory notes D. All of the above
- 42
67. In which kind of contract does each side promise something in consideration for the promise of the other?  
 A. Bilateral C. Trilateral  
 B. Unilateral D. None of the above
- 43
68. Which is true about signing real estate contracts?  
 A. May include signatures of buyer, seller, spouse, and co-owner  
 B. An agent with proper authority can sign for a principal  
 C. Corporate officers who sign must also affix corporate seal  
 D. All of the above
- 43
69. The Statute of Frauds exists to prevent unscrupulous people from taking advantage of others through:  
 A. Dishonest conduct C. Forgery  
 B. Perjury D. All of the above
- 44
70. In contracts, when a new obligation is substituted for one which already exists, this is known as:  
 A. Novation C. Substitution  
 B. Assignment D. None of the above
- 43
71. Which of the following contracts must be in writing?  
 A. An agreement that cannot be completed within one year from when it is signed  
 B. A promise to pay off another person's debts  
 C. An agreement depending on marriage (except for agreeing to marry)  
 D. All of the above
- 45
72. Which of the following is subject to "specific performance?"  
 A. A real estate sales contract C. Both "A" and "B"  
 B. An option D. Neither "A" nor "B"
- 45
73. Which of the following is not specifically enforceable?  
 A. Personal service  
 B. Illegal acts  
 C. Getting a third party's consent to something  
 D. All of the above

- 44 74. Which of the following means to put everything back the way it used to be, as though a contract had never existed?  
 A. Rescission  
 B. Novation  
 C. Assignment  
 D. None of the above
- 45 75. Under the law which took effect July 1, 1978, the liquidated damages clause in contracts is considered:  
 A. Invalid  
 B. Valid  
 C. Good for only some contracts  
 D. None of the above
- 54 76. What kind of action removes liens from titles?  
 A. Partition action  
 B. Quiet title action  
 C. Declaratory relief action  
 D. None of the above
- 55 77. Which is a type of will recognized by California law?  
 A. Noncupative  
 B. Holographic  
 C. Witnessed  
 D. All of the above
- 54 78. What kind of action is taken if someone has a lien on property and cannot collect from the owner?  
 A. Foreclosure action  
 B. Partition action  
 C. Declaratory relief action  
 D. None of the above
- 59 79. In which of the following ways can the relationship of principal and agent be created?  
 A. By agreement  
 B. By ratification  
 C. By estoppel  
 D. All of the above
- 54 80. If someone other than the legal owner takes possession of property without the owner's permission and lives there openly for at least five years, claiming to be the owner and paying property taxes for those five years, that person can become the owner by:  
 A. Adverse possession  
 B. Estoppel  
 C. Unfriendly possession  
 D. None of the above
- 97 81. Escrow departments can be found in:  
 A. Title companies  
 B. Savings and loans  
 C. Banks  
 D. All of the above
- 54 82. "Improvements in error" and "addition of fixtures" are both examples of ways to acquire property by:  
 A. Accession  
 B. Accretion  
 C. Estoppel  
 D. None of the above
- 54 83. When a river dries up or changes course, the addition of land is called:  
 A. Erosion  
 B. Avulsion  
 C. Reliction  
 D. Alluvion
- 55 84. When land is torn away, as by an earthquake or tidal wave, this is called:  
 A. Alluvion  
 B. Erosion  
 C. Avulsion  
 D. Reliction
- 54 85. What kind of action does the court take when it is asked to decide who actually has title before contending parties can take further action?  
 A. Quiet title action  
 B. Declaratory relief action  
 C. Partition action  
 D. None of the above
- 69 86. How do mortgage companies get the money they need to originate loans?  
 A. By borrowing on their line of credit with commercial banks  
 B. By selling short-term debt instruments called "commercial paper"  
 C. Neither "A" nor "B"  
 D. Both "A" and "B"
- 54 87. If justice is better served by leaving title with a new owner than by restoring it to a former owner, the courts may transfer title by:  
 A. Equitable estoppel  
 B. Quiet title  
 C. Partition  
 D. None of the above
- 58 88. The Civil Code provides that every agent has authority:  
 A. To do everything necessary or proper or usual in the ordinary course of business for effecting the purpose of the agency  
 B. To make representations as to facts involved in the transaction in which the agent is engaged  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
- 109 89. Creating an easement by using someone else's property without permission for a long time and on a regular basis is called:  
 A. Prescription  
 B. Proscription  
 C. Abandonment  
 D. None of the above

90. The American Land Title Association was developed for:  
 A. Nonresident lenders  
 B. Local lenders  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
91. In appraisal practice, "fair market value" assumes:  
 A. Buyer and seller are motivated by self-interest  
 B. Buyer and seller are well informed and are acting prudently  
 C. The property is exposed for a reasonable time on the open market  
 D. All of the above
92. Which of the following is based on an examination of the public records?  
 A. Abstract-opinion  
 B. Certificate of title  
 C. Guarantee of title  
 D. All of the above
93. Under the provisions of the Insurance Code of California, each title insurance company organized under the laws of this state must have at least \$500,000 paid-in capital, and must deposit with the Insurance Commissioner a guaranteed fund of:  
 A. \$ 20,000  
 B. \$ 25,000  
 C. \$ 50,000  
 D. \$100,000
94. Which is true of an independent contractor, as opposed to an employee?  
 A. The independent contractor sells final results rather than time  
 B. The independent contractor's methods are not subject to the control of another  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
95. Which is true concerning restrictions on an agent's authority?  
 A. An agency to sell does not carry with it the authority to modify or cancel the contract of sale after it has been made  
 B. A mere agency to sell property ordinarily empowers the agent to find a purchaser but does not authorize the agent to enter into a contract to convey on behalf of the principal  
 C. Both "A" and "B"  
 D. Neither "A" nor "B"
96. Constructive eviction refers to:  
 A. Eviction by the landlord  
 B. Right of tenant to abandon premises under certain conditions  
 C. Eviction because of new construction  
 D. None of the above
97. Which are promises to do or not do something?  
 A. Conditions  
 B. Deed restrictions  
 C. Banks  
 D. Covenants
98. The subdivision land law defines a subdivision as how many lots or parcels?  
 A. Twenty or more  
 B. Fifteen or more  
 C. Ten or more  
 D. Five or more
99. Unstable rising prices and excessive money together create:  
 A. Savings  
 B. Recession  
 C. Depression  
 D. Inflation
100. Capitalization rates may be determined by:  
 A. Direct comparison  
 B. Using market and sales data  
 C. Neither "A" nor "B"  
 D. Either "A" or "B"

**NOTICE:**  
 When you complete this exam, these questions must be returned to your monitor with your answer sheet. Both these items must be mailed by your monitor to:

Real Estate License Services  
 5059 Newport Ave. #209  
 San Diego, CA 92107

If you have any questions, please telephone (619) 222-2421.



# 1

## LICENSING LAW

### INTRODUCTION

California has been the leader in real estate licensing since the first laws for it were enacted. Often California's laws serve as models for other states. Before real estate licenses are granted, qualifications are thoroughly checked and knowledge is tested.

This chapter explains the types of real estate licenses available, requirements for getting them initially and for renewing them, and some laws related to licenses.

Incidentally, none of the fees required for licensing is refundable.

### PURPOSE OF LICENSING LAWS

Licensing laws were developed in order to protect the public by regulating real estate agents. Almost every activity related to a real estate transaction requires a license to perform.

If the agent has no license for his activities, he cannot receive commissions or fees for performing them.

Anyone found guilty of operating without a license faces a possible \$1,000 fine or six months in jail or both. Corporations can be fined up to \$5,000.

Anyone who pays an unlicensed person for real estate transactions requiring licenses is guilty of a misdemeanor and can be fined up to \$50.

### BROKER'S LICENSE

Anyone who wants a real estate broker's license in California must be at least 18 years old and honest and truthful. He must also file necessary applications, prove required experience and education, pass a qualifying exam, and pay all required fees.

One must meet all qualifications prior to being scheduled for examination. The Department of Real Estate will conduct no

evaluation of claimed experience or education with applicants in person or on the telephone. Satisfaction of requirements is a matter of records and filings. In order to be evaluated by the DRE for previous college courses, degrees, or experience, you must submit the following materials:

- a. Examination application (form RE 400)
- b. Appropriate fee
- c. Transcripts of your college courses and/or degree
- d. Catalog description of any courses that you wish to substitute for the statutorily required courses
- e. Employment Verification Form (form RE 226).
- f. Equivalent Experience Form (form RE 227)

When you apply for qualification, as described above, you may find that you do not meet all of the qualifications. If that is the case, you will be given two years from the date of the receipt of your application in which to complete the qualifications and take the examination for your license.

If you do not pass the examination during the two year period, the application expires, and you will be required to resubmit all qualifying material with the appropriate application and fee.

There are no upper limit age restrictions for a California real estate license. Nevertheless, to apply for a license you have to be 18 years of age or older — minors are not eligible.

There are certain residency requirements. One need not necessarily be a resident of California, but the state in which one resides must allow California residents to qualify for and obtain a real estate license in that state. Otherwise, one may not apply for either an original or a renewal license.

### EDUCATION

If you wish to apply for a real estate broker's license in California, you must successfully complete certain college level courses, required by state law, plus a certain number

hour course in ethics, professional conduct, and legal aspects of real estate, and not less than 21 clock hours of courses related to consumer protection.

**Effective January 1, 1986, salespersons who were required to complete Real Estate Principles and two other qualifying college-level real estate courses will not be required to meet the continuing education requirement for the first renewal except for the three-hour Ethics course and three-hour Agency course. Please note that neither the salesperson nor broker license qualification courses satisfy continuing education requirements.**

## FINGERPRINTS

After passing the examination, the successful applicant for a salesperson's license will receive a Salesperson License Application (RE 202). This form must be completed and returned along with the appropriate fee, one set of classifiable fingerprints, and the fingerprint processing fee, within one year of the examination date. The successful broker applicant will receive a Broker License Application (RE 200), which must be completed and returned along with the appropriate fee and, if needed, one set of classifiable fingerprints and the fingerprint processing fee within one year of the examination date. Some new brokers may have never filed fingerprints because they may never have had a salesperson's license.

Generally, applicants for any real estate license must submit one set of classifiable fingerprints, acceptable to the State Department of Justice, unless the applicant is currently licensed or has held a license which expired less than two years ago.

Fingerprints may be taken at any of the following DRE district offices:

Los Angeles — Executive Office  
107 S. Broadway, Room 8107  
Los Angeles, CA 90012

San Francisco  
185 Berry St., Room 5816  
San Francisco, CA 94107

San Diego  
1350 Front St., Room 5008  
San Diego, CA 92101

Santa Ana  
28 Civic Center Plaza, Room 324  
Santa Ana, CA 92701

Fresno  
2550 Mariposa St., Room 3070  
Fresno, CA 93721

Arrangements may be made to have the prints taken for a fee at most sheriff's offices, police stations, Department of Motor Vehicles offices, or other facilities where acceptable prints may be obtained. Prints must be taken on a California license application Fingerprint Card (BID-7, Rev. 2/82). This form is usually available at the fingerprinting locations.

An additional charge, payable to DRE, is required for processing the fingerprint card through the Department of Justice. This fee must be included with the license application and license fee. Check with a regional office for current fees, or avail yourself of the Department's most recent reference book.

## PUBLICATIONS

Speaking of the Reference Book, this is a book which explains practices common to real estate, and contains information concerning real estate licensing and examinations; legal, financial and economic aspects of real estate; business opportunities; and mineral, oil and gas brokerage. In addition, the book includes reference materials, sample real estate forms, and various useful charts and tables. As of this printing, the price is \$13.25.

Additionally, the Department publishes the Real Estate Law Book and its supplements. This book contains the full text of the Real Estate Law, which is part of the California Business and Professions Code. Also included are the Regulations of the Real Estate Commissioner, the Subdivision Map Act, and excerpts from other California codes pertaining to real estate.

The DRE also publishes the "Bulletin," four times a year, and this is mailed to all licensees in order to help them stay informed about matters relating to the Department, changes affecting the laws and regulations, and other matters of concern to licensees. You can obtain single copies of the Reference Book and Real Estate Law over the counter at district offices, or you may order them from the Department by mail, using checks, money orders, or cashier's checks. Books are not sold for cash.

## THE EXAMINATIONS

Remember, the law makes no distinction between broker and salesperson license examinations insofar as subject material is concerned. The two examinations are similar in format and in weighting of content. The salesperson candidate must correctly answer at least 70% of the questions. The test for a broker license contains more difficult material. To pass the examination, the broker candidate must correctly answer at least 75% of the questions.

#8

7

**Continued Misrepresentation:** If a licensee is guilty of repeated misrepresentations or false promises, he may be disciplined by the commissioner.

**Divided Agency:** The licensee must inform all parties if he is acting as agent for more than one of them.

**Commingling and Conversion:** Both involve mixing client's and broker's money. If it is mixed and not used, it is commingled. If it is mixed and the broker uses or misappropriates it, this is called conversion. Converting money is generally a more serious offense than commingling it.

**Definite Termination Date:** A definite date must be set for ending exclusive listings related to all real estate transactions, including bonds and loan authorizations. It can be on a specific day or after a specific period of time has elapsed. No exclusive listing is satisfactory if the termination date cannot be determined.

**Secret Profit:** This occurs when the broker tries to acquire property at a low price through a "dummy" buyer, knowing that he has already lined up a higher offer from another buyer. The difference in the purchase prices is his secret profit.

**Listing-Option:** If the licensee has separate forms for listings and options, this section does not apply. However, if both option and listing are on the same form, the principal must be told how much profit the licensee will make and the principal must agree to that in writing, before the licensee can exercise the option.

This prevents the licensee from making too much profit at the expense of the principal. It is designed to protect their close financial relationship.

**Dishonest Dealing:** This includes everything, whether it is specifically covered by a real estate license or not.

**Signature of Prospective Purchasers:** The owner of a business must agree in writing that it is for sale before a broker is allowed to find a buyer.

This law came into being because in some areas brokers often used an agreement called a "send-out list." Without consulting owners of the businesses on their "list," brokers would get prospective buyers to sign an agreement to pay the broker a fee if they bought a business of that list, whether they used that broker or not.

following reasons: obtaining a license by fraud, convictions (felony, misdemeanor, or moral turpitude), false advertising, negligence or incompetence, failure to supervise salespersons, violating government trusts, violating the terms of a restricted license, violations of Franchise Investment Law and/or Corporations Code and/or other sections of Real Estate Law, and other dishonest or criminal conduct of any kind.

It also prohibits misuse of trade name. The term "Realtors" may only be used by those who are members of local or national associations of real estate boards. In fact, any insignia or "term" of any real estate organization is protected here.

## OTHER VIOLATIONS.

If a broker hires someone who has no license to transact business requiring a license, the broker's own license can be suspended or revoked.

The broker's license can also be suspended or revoked if he fails to do any of the following:

- maintain a place of business in California; get a branch office license for each branch if he has more than one place of business;
- have all licenses (whether for people or for business) available for inspection at the proper office; notify the Department of Real Estate when a salesperson is hired and when that employment is terminated;
- notify the Real Estate Commissioner if a salesperson is discharged for cause;
- ensure that buyer and seller both receive notice of sales price within one month after completion of the sale;
- give a copy of a contract to the person signing it at the time it is signed;
- meet responsibilities for handling trust funds and recording trust deeds;
- keep records available for inspection for three years (including all listings, trust records, canceled checks, deposit receipts, etc.);
- obey all regulations of the California Real Estate Law. Violations of sections of that law dealing with subdivisions and with real property securities are punishable by fines and/or imprisonment.

## VIOLATIONS — SECTION 10177

Section 10177 of Real Estate Law permits the Real Estate Commissioner to take action against a licensee for the

## REAL ESTATE BULLETIN

The Real Estate Bulletin is published quarterly by the Department of Real Estate. It contains the latest information

on changes and current practices. All licensed brokers and salespersons are automatically put on the mailing list for the Bulletin.

## PAMPHLET

"Instructions to License Applicants" is a free pamphlet available from the Real Estate Commissioner. It discusses exam procedure and steps for getting an original license.

## HISTORICAL BACKGROUND OF LICENSING LAWS

The so-called "Real Estate Law" is codified as Division 4 of the Business and Professions Code, and consists of two parts. Part 1 covers Licensing of Persons (Sections 10000 to 10602), and it is this part which is normally referred to as "The Real Estate Law." The second part of Division 4 of the B&P Code covers Regulation of Transactions, and is called The Subdivided Lands Law (Sections 11000-11202). We are concerned primarily with Part 1 of Division 4. The full text of the law and Regulations of the Real Estate Commissioner which clarify, implement, interpret or make specific its various sections appears in the "Real Estate Law," a book published by the Department of Real Estate.

\* \* \* \* \*

As America outgrew its pioneering and homesteading stages of development and moved steadily toward greater and greater urbanization, city dwellers across the land found they personally could no longer satisfactorily "strike a deal" with strangers in bargaining for land and homes.

The need for an intermediary to provide basic real estate knowledge and services, to negotiate and bring about desired results, was very real. This need was met in the person of the real estate agent, who continues to fill this important role in the complexities of today's society.

However, along with increasing opportunities to provide real estate agency services to the maturing nation came certain abuses of the public trust in the form of unethical, illegal or sharp practices by dishonest or incompetent agents operating in a climate of unorganized and often unscrupulous competition. Real estate practitioners themselves began to see the need for some type of controlling organization.

The general public's legitimate interest in the buying, selling, exchanging and financing of real property predictably led to the regulation of the real estate business through the adoption, state by state and over time, of reasonable legislative and administrative controls. The enactment of

such controls is within the general power of a state to regulate any occupation whose membership should meet specified qualifications.

Today, all fifty states and the District of Columbia have enacted statutes governing to some degree the licensing, regulation and conduct of real estate agents. The nation's first real estate licensing law was passed in California in 1917. It was challenged in the courts and declared to be unconstitutional. The Real Estate Act of 1919 was then adopted and upheld by the State Supreme Court as being a reasonable exercise of the power of the state to regulate the conduct of its citizens in the interest of the common good. With subsequent amendments and additions the law has been in effect ever since.

Real estate agents operating in the 1980s provide both basic services and specializations to the modern community. General brokerage, property management, development, financing, counseling, franchising and appraising are examples of the services offered by today's real estate professionals in the fields of residential, commercial and industrial, investment, special purpose, raw land, and agricultural real estate. Consumer concern that high business standards be maintained by today's broker professional is no less that it was when the real estate profession first came under regulation.

During the past 65 years, as weaknesses in existing laws to control abuses in real estate activities were revealed, corrective legislation was passed by socially responsive legislators until today a complete set of reasonable licensing, regulatory and subdivision marketing controls are in place and enforced by the California Real Estate Commissioner. As you may already know, this power of government regulation and supervision is called "police power."

Real Estate Act — A Brief History. The California Department of Real Estate, whose chief officer is the Real Estate Commissioner, was created by legislative act in 1917. It was the first law of its kind providing for the licensing and regulation of real estate agents. It has served as a pattern for similar legislation in many other states.

As first enacted, the law was declared unconstitutional by the state Supreme Court in Raleigh, 177 C. 746 on March 19, 1918. Opponents had claimed the act was unreasonable interference with the right of every citizen to engage in legitimate and useful occupation and that the power given to the commissioner was arbitrary. In its ruling the court found the act invalid because it exempted from its provisions those corporations and persons who had "received from the Insurance Commissioner or the Bureau of Building and Loan Supervision a certain authority or license to do business within the state."

The court noted the requirements for obtaining licenses from the Insurance Commissioner were much more simple

and far less burdensome than those imposed upon real estate brokers and salespersons by the real estate act, e.g., insurance licensees did not require recommendations vouching for their truthfulness and honesty; did not need a bond; and did not need to maintain an office. The court could not discern any reason for these special conditions or concessions but raised no other objections to the act.

**Constitutionality of Act Declared.** The constitutionality of the act was still in question when a new Real Estate Commissioner, Ray L. Riley, was appointed on July 28, 1919. Through his urging, the Legislature passed the Gates Bill which amended the original real estate law. As amended, the law was upheld by the Supreme Court in November, 1919.

Among the strongest supporters of the real estate licensing law was the organized real estate industry itself. The industry believed the reasonable regulation of those engaged in the real estate business would benefit the public and assist in creating and maintaining higher professional standards and ethical practices in the conduct of real estate brokerage activities.

Thus the law is designed primarily for the protection of the public in real estate transactions in which the services of an agent are employed. By requiring qualifications for licensing (the original act did not require a licensing examination) the Commissioner is able to ascertain that persons acting in the capacity of a broker or salesperson have certain knowledge qualifications.

This power given to the Commissioner is not arbitrary and is not without control or guidance. If the Commissioner finds that an applicant for license is not honest and truthful, that finding must be based upon facts which reasonably justify this conclusion. When an applicant in fact has the qualifications required by law, the Commissioner must issue the license.

By requiring qualifications for license and by the establishment and enforcement of definite standards and practices, the law has also played an important part in the continuing industry drive for professional designations and recognition for those engaged in real estate practice.

Commissioner's Jurisdiction Extended. Since the passage of the original act creating the Department of Real Estate, the jurisdiction of the Real Estate Commissioner, at first only over the licensing of real estate brokers and salespersons, has been gradually extended.

Beginning in 1933 the administration and enforcement of those provisions of the Business and Professions Code regulating the sale or lease of subdivided lands (Subdivided Lands Law) have been a responsibility of the Commissioner and the department with gradual yet consistent increases

over time in the degree of authority given to the Commissioner by law.

As with the licensing law, the subdivided lands provisions were attacked as being unconstitutional in that they placed unreasonable burdens on the exercise of property rights, they were vague and uncertain, and they benefited only a special class and not a whole public. Again, our Supreme Court held these contentions were not sound. The court held that the object of the law was the prevention of fraud and sharp practices in a type of real estate transaction peculiarly open to abuses. The court said the method of furnishing information to real property purchasers which involved investigation and written disclosure of certain essential facts was protection for innocent purchasers.

**Extensions of Authority.** Licensing and regulatory controls for mineral, oil and gas brokers were enacted by law in 1943, as were the activities of business opportunity brokers. Later legislation permitted and still allows any licensed real estate broker or salesperson to engage in the business opportunity field under a general real estate license.

In 1955, because of complaints about practices of some brokers which were clearly adverse to the public good, the Legislature passed and has since amended and strengthened statutes regulating the handling of real property loans by licensees. Substantial new laws and regulations were adopted in 1982 regulating disclosures in mortgage loan broker activities. These are covered later in this course.

On January 2, 1970, the Commissioner became responsible for administering the Real Estate Syndicate Act relating to some types of real estate syndicates that were formerly under the jurisdiction of the Corporations Commissioner. However, under a law change on January 1, 1978, this jurisdiction was returned to the Corporations Commissioner.

On July 1, 1975, brokers and salespersons under the authority of their real estate licenses, became authorized to engage in the sale, purchase, negotiation, etc., of mobile homes registered for at least one year with the Department of Motor Vehicles. Effective July 1, 1980, licensees may also negotiate the sale of other mobile homes provided the requirements of the Health and Safety Code Section 18551 for transforming a mobilehome to real property have been satisfied.

On September 25, 1980, prepaid rental listing services became regulated and require the licensing of any person rendering such services, other than a real estate licensee, by the Department of Real Estate.

**Public Trust.** In the brief history given, it can readily be understood that brokers and salespersons are engaged in

many activities, as representatives of others in a confidential and fiduciary capacity. The public has more than a passing interest in seeing that the trust of the community is well placed in the real estate professional. To that end, the state seeks to help justify this trust and confidence by prescribing certain educational, experience and ethical requirements for real estate practitioners and subjecting to discipline those licensees who violate this trust.

**Decisions and Rulings Affecting Real Estate Law.** What is commonly referred to as the "Real Estate Law" must clearly be distinguished from what is known as real property law, law of agency, contract law, or other legal aspects of real estate ownership and conveyancing. Although these sets of laws interrelate and overlap, they are nevertheless different legal rules and should be separately understood. The Real Estate Law affects the licensing and conduct of persons acting as real estate agents. The law is enforced at special administrative hearings by the Commissioner rather than by a court of law. You understand by now that this course, titled "Real Estate Law," includes a study not only of the so-called Real Estate Law, as just described, but also the other sets of laws which comprise the legal aspects of California real estate activity.

#46 The California Real Estate Law, or license law, as it is sometimes referred to, has two principal purposes: (1) the protection of the general public from harm at the hands of dishonest and incompetent agents and (2) the protection of the reputation of honest agents against the adverse publicity and public resentment often caused by the unprincipled and unscrupulous who would infiltrate the agent's ranks.

\* \* \* \* \*

## CAPSULE OUTLINE SUMMARY OF THE REAL ESTATE LAW

Since the entire text of the Real Estate Law and a detailed analysis, as published by the state, is 124 pages in length, and since this course is meant to acquaint you with many more aspects of real estate practice in California, the Real Estate Law has been compressed into an outline of essential information, which follows. The student is advised to study the outline, which presents the essential information in clear, easy-to-follow steps, and be prepared to answer questions based on the information contained therein.

\* \* \* \* \*

### THE REAL ESTATE LAW

#### I. Police Power

A. Definition: Police power is the authority of the state to

enact legislation within constitutional limitations in order to ensure the safety, health, morals, and general welfare of the people of the state.

#### B. Constitutional Justification.

1. Contained in the Bill of Rights to the U.S. Constitution
2. It states, "The powers not delegated to the United States by the Constitution nor prohibited to it by the states are reserved to the states respectively or to the people."

### II. Need for license law: To protect the public from unqualified and unethical real estate agents.

#### III. Real Estate Bureaucratic Structure

##### A. The Department of Real Estate

1. Was created in 1917
2. Has the following responsibilities:
  - a. license and regulate real estate agents
  - b. regulate the sale or lease of subdivided land
  - c. govern the handling of real property loans by real estate licensees
  - d. regulate certain types of mobile home transactions
  - e. manage prepaid rental listing services run by someone other than a licensee.

##### B. Real Estate Commissioner

1. Job background
  - a. The Commissioner is the chief executive officer of the Department of Real Estate and the chairperson of the Real Estate Advisory Commission
  - b. The Commissioner is appointed by the Governor
  - c. The Commissioner must have five years of active experience as a California real estate broker or five years of related experience in California in the last ten years.

##### 2. Overall objectives of the Commissioner

- a. Decide departmental policy
- b. Enforce the provisions of the Real Estate Law

##### 3. Specific duties of the Commissioner

- a. Screen license applicants
- b. Investigate nonlicensees conducting business transactions requiring a real estate license
- c. Review complaints against licensees
- d. The pertinent regulations within limits of non-exempt franchises, real property securities and the sale of subdivisions
- e. hold formal hearings within the limits of the Administrative Procedures Act
- f. NOT settle commission disputes

# 2

## PROPERTY

### INTRODUCTION

What is property? How is it determined? This chapter takes a look at real vs. personal property, types of estates that can be owned, and legal descriptions of property.

### REAL VS. PERSONAL PROPERTY

What is the difference between real and personal property? The official legal description of personal property is “anything which is not real.”

Therefore, in order to understand the difference between the two categories, it is necessary to know what real property is and how it is defined and limited.

### REAL PROPERTY

When a person has real property, he owns a piece of land that can be precisely limited, and he owns the air above it, as well as whatever is attached to the surface of the land and whatever is below the surface. He also owns the right to use these things and to benefit from them. This “bundle of rights” is an important part of the term “real property.”

This term is also used to refer to immovable objects on the surface of the land. This includes movable parts of immovable objects as long as they are permanently attached, such as doors and windows. It also includes emblements, which will be discussed later in this chapter.

### REAL ESTATE

“Real estate” is often used interchangeably with “real property.” The two terms are nearly identical. However, only “real property” includes rights in its definition. So “real estate” refers to physical things — the land, the air above

it, whatever is fixed to its surface, and whatever is in the ground below.

### SURFACE RIGHTS

Surface rights relate to use of whatever is on the surface, whether natural or man made, as long as it can legally be considered immovable. Immovable objects include trees, streams, and buildings, and anything securely attached to them.

### AIR RIGHTS

Air rights used to mean all air from the surface of the land to infinity. Now, however, air traffic has the right to use some of that space, although it is not supposed to interfere with an owner’s enjoyment of his land.

Air rights can be sold. Some airports have bought neighboring air rights to ensure space for planes’ glide paths. Buildings in large cities are sometimes built over an existing railroad or other low-ceiling structure by purchasing air space above a certain distance from the ground, plus enough land for the buildings’ support pillars (caissons).

### SUBSURFACE RIGHTS

Subsurface rights may also be sold or leased. This is most often done in the case of oil, gas, or mineral resources found below ground.

### PERSONAL PROPERTY

Personal property is whatever is not real property. That means whatever is not permanently fixed to the land, including furniture, pets, bank accounts, and so on.

Non l

#29

(17)

#1

This includes that carved oak door and such items as TV antenna, linoleum on the kitchen floor, curtain rods, window screens, and wall-to-wall carpeting.

In a rental situation, a fixture belongs to the landlord. However, the tenant is entitled to remove anything the tenant installed, with two exceptions: removal cannot damage the premises, and the item cannot have been installed in such a way as to become a fixture.

## TRADE FIXTURES

Trade fixtures are owned by the tenant. In order to conduct business, he attaches them to the property he rents or leases. However, when he leaves, he takes his trade fixtures with him. A lease agreement generally calls for him to restore property to its original condition, allowing for normal wear and tear.

Examples of trade fixtures are gas pumps, bowling alleys, film processing machines, display counters, refrigerated cases, store shelves, and restaurant equipment.

If the tenant does not remove trade fixtures on or before the last day he rents the place, the fixtures become the landlord's property.

## SEVERANCE AND ATTACHMENT

Real property can become personal property and personal can become real. Severance — cutting it loose or separating it — is the key to the first. Attachment — fastening it on or adding it — is the key to the second.

Crops are real property when they're growing. If they are harvested, whether by picking, cutting, or digging, they become personal property.

A tree is real property as long as it's growing. When it's cut down, it becomes personal property.

A vein of coal is real property as long as it's in the ground. When it has been mined and brought to the surface, it becomes personal property.

The reverse is also true. If a home owner buys a mailbox to put down by the road, the mailbox is personal property until he actually installs it. Then it becomes a fixture, i.e., real property.

Redwood for pool decking is personal property when it's a stack of lumber. Once the pool deck is built, it's real property.

Cement blocks, mortar, and steel rods are personal property until they are turned into a blockwall fixture.

## LAND

How is real property legally identified? By describing the land. Every parcel of land has a description that will fit only it and none other, somewhat like fingerprints for people.

This legal description must be included in any real estate sales contract.

There are three basic ways to describe property: 1) metes and bounds; 2) government survey method; and 3) lot and block number.

## METES AND BOUNDS

Metes and bounds is the longest description of a piece of land. Metes refers to distance (feet, yards, etc.). Bounds refers to the boundaries of the parcel, whether artificial or natural.

This description starts from a fixed point, which has to be described precisely. If the starting point is wrong, the whole description is wrong. Therefore, metes and bounds descriptions must make the starting point unmistakable.

Once the starting point is determined, the description goes along one side of the parcel, noting which direction and the exact distance. It may be necessary to state the degree of turn from north and to give exact descriptions of variables that keep the line from being perfectly straight. Boundaries such as streets simplify this, as the line can follow their course without more detail. If one line of the property parallels another, this can be part of the description.

At the corner, direction of turn must be stated and exact distance of this side given. Again, it may be necessary to measure exact degree of turn and to give precise descriptions of any irregularities in the line.

This process is repeated at the next two corners and will eventually lead back to the starting point. Any metes and bounds description must return to the starting point.

To define property, it is easy and natural to use landmarks, or markers, such as mountains, trees, rivers, buildings, rocks, and so on. But they should be used only if absolutely



necessary. Trees can die or be cut down. Rocks can be dug up and moved. Buildings can be built, destroyed, or added on to. Rivers can be dammed and mountains can be cut down or dug into. If such markers are used as part of metes and bounds descriptions, every identifying feature of them must be included.

Metes and bounds descriptions can be so detailed and lengthy that only a surveyor or a civil engineer can follow them. They should be used only as a last resort.

An example of a metes and bounds description: Beginning at the north west corner of the intersection of Wills Road and Jones Creek, proceed west 350 feet along Wills Road, then turn due north for 150 feet, then turn east parallel to Wills Road to the bank of the creek, then proceed southerly along the creek bank back to the starting point.

## MEASURING

#69 Measurements of length commonly used in legal descriptions are rod, chain, and mile.

Rod equals 16.5 feet

Chain equals 66 feet

Mile equals 5,280 feet, or 320 rods, or 1,760 yards

Measurements of area include square feet, square yards, and acres.

1 sq. foot equals 144 sq. inches #50

1 sq. yard equals 9 sq. feet

#51 1 acre equals 43,560 sq. feet, or 4,840 sq. yards, or 160 sq. rods

Measurement of degree is with a circle and begins at the center of the circle. It proceeds east or west of the north/south line through the center of the circle.

#52 A circle is divided into 360 degrees. A half circle is 180 degrees and a quarter circle is 90 degrees. Each degree has 60 minutes; each minute has 60 seconds. For legal descriptions, "one minute" would be written 1' and "one second" would be 1" with no spaces between. Thus, 30°, 5 minutes 3 seconds would be written 30°, 5'3." Thirty°, 5 minutes would be 30°, 5'0."

## GOVERNMENT SURVEY METHOD

As reference points for land descriptions, the government has set up a series of intersecting lines on true parallels of latitude. These are called base lines and principal (or prime) meridians.

#53 Actually, base lines follow true latitude lines, and meridians follow true longitude lines. Because of the earth's curve, correction lines have been established 24 miles on each side of a base line or meridian. Correction lines for meridians are also called guide meridians, while correction lines for base lines are also called standard parallels.

Each base line and meridian has its own distinctive name. Three intersections are in California:

Humboldt Base Line and Meridian (north west part of state); Mt. Diablo Base Line and Meridian (central California); San Bernardino Base Line and Meridian (Southern California).

## TOWNSHIPS AND RANGES

From these base lines and meridians, the government plotted land into sections. #24

Lines running north and south, at 6 mile intervals from the meridian, are ranges. Lines running east and west, at 6 mile intervals from the base line, are township lines.

Intersections of ranges and township lines enclose areas of 36 sq. miles (6 miles square). This area is also called a township. #55

Townships are identified by their location north or south of the base line and their range east or west of the meridian, counting outward from base line or meridian.

To eliminate error, the description is usually in words with the abbreviation in parentheses. Reversed order is also acceptable.

Example: The northwest quarter (N.W. 1/4) of the southeast quarter (SE. 1/4) of Section 14, Township 3 North (T. 3 N.), Range 1 West (R. 1 W.). Humboldt Base and Meridian (H. B. & M.).

## TOWNSHIP MEASUREMENTS

Townships have 36 sections, each one square mile in size. These sections may be divided into quarter-sections, or even fractions of quarter-sections.

For area of a township section:

# 56

- 1 section equals 1 sq. mile, or 640 acres
- 1/4 section equals 160 acres
- 1/4 of 1/4 section equals 40 acres

**For length of sides of township sections:**

- 1/4 mile= 1,320 feet(length of 1 1/4-section)
- 1/2 mile= 2,640 feet(length of 2 1/4-sections)
- 3/4 mile= 3,960 feet(length of 3 1/4-sections)
- 1 mile= 5,280 feet(length of 4 1/4-sections or 1 section)

**TOWNSHIP PLAT**

When townships within the plat are divided into sections, each section is given a number from 1 to 36. Numbering runs right to left on the top row of six numbers, left to right for 7-12, right to left for 13-18, left to right for 19-24, right to left for 25-30, and left to right on the bottom row for 31-36. In other words, it zigzags back and forth in regular pattern, beginning on the north side in the northeast corner.

When sections are quartered, they are referred to as north-east quarter (N.E. 1/4), north west quarter (N.W. 1/4), south-west quarter (S.W. 1/4), and southeast quarter (SE. 1/4).

For descriptive purposes, each section and quarter-section can be quartered, and these fractions quartered, using the same descriptive phrases. Reference could be to the N.E. 1/4 of the S.W. 1/4 of Section 6, or the S.W. 1/4 of the N.E. 1/4 of the S.W. 1/4 of Section 6.

The trick to reading township plat descriptions is to work back from the comma or break. First establish which section you are concerned with. Then find the first comma in the description and work back through that phrase. See the Reference Book published by the California Real Estate Commission for more detailed examples of this. Questions about reading township plat descriptions are often on exams for broker's and salesperson's licenses.

**GOVERNMENT LOTS**

Some lots were less than a quarter-section in size because of a river, lake or other geographical feature. Other lots on

the north or west boundaries of a township were used for corrections based on the earth's curvature or for various errors.

All lots of odd sizes became government lots. No government lot contains a standard number of acres. They are identified legally by their lot numbers.

**LOT AND BLOCK NUMBERS**

Sections of land can be further subdivided into blocks separated by streets, and the land within a block can be divided into lots. Each block is numbered and each lot is numbered on a separate system.

A surveyor or civil engineer must prepare a plat of survey or record of survey map which clearly indicates the limits of the subdivision.

As long as the subdivision complies with all local ordinances and meets local requirements, a map showing these lot and block numbers can be filed at the county recorder's office for the county in which the subdivision is located.

Names of city (if there is one), county, and state need to be included on that map and in every description of land using lot and block numbers. This avoids any possibility of confusion.

**INFORMAL DESCRIPTION**

Sometimes it's easier to use an informal description to refer to a piece of land. This could be by street number (124 W. Willow Ave.) or by a name it's been given ("Bag End" or "Rancho La Paloma"). Sometimes it's enough just to refer to "my lot on Whittier Boulevard."

But none of these are legal descriptions, and title companies prefer not to insure title to land that is so imprecisely described.

**PERSONAL PROPERTY -- THE MODERN CONCEPT**

Earlier we said that personal property consists of every kind of property that is not real. It includes money, movable goods or chattels, evidences of debt and choses (things) in action. The last term is a legal phrase used loosely to

regardless of what may have happened to the estate in the meantime or how many times it may have been sold. It is essential that any purchaser of a life estate understand that.

to pay for unnecessary improvements unless he agreed to them in advance.

If tenants in common are forced to sell the property in order to pay one owner his share, this is called a "partition sale." More usually, the new owner (buyer, inheritor, creditor) simply becomes a tenant in common with the others.

## OWNING REAL PROPERTY

#40  
A person can own real property alone or with other people. Owning it alone is "separate ownership," which can be referred to in several ways (see next page). Owning with others is called "concurrent ownership" or "co-ownership," which in California has three main forms involving private parties: "tenancy in common," "joint tenancy," and "community property."

### (I) Separate Ownership

"Separate ownership" is also known as "sole ownership," "several ownership," and "ownership in severalty." Title is "vested" in one person, i.e., owned by one person.

This person has the right to sell the property, sell or lease the rights, leave it to someone in his will, and use it in any way he pleases, as long as he violates no laws or local ordinances. He is also responsible for paying property taxes, complying with ordinances or paying fines for non-compliance, and taking whatever care of the property he feels is necessary.

### (II) Tenancy in Common

#10  
The majority of people not married to each other who own property together have "tenancy in common." In fact, the law presumes this to be the case, except for a married couple, unless there is written proof that some other form of ownership was intended.

Any number of persons may be "tenants in common." They share property equally or unequally as they choose. The law presumes they share equally, if there is no proof otherwise.

Each person has complete rights to his percentage of the whole. He can sell his portion to someone else or use it as collateral for a loan. When he dies, his portion goes to his heir(s). A new owner becomes a tenant in common with the others.

Any rent or other income from the property is split among the tenants in common, according to their share of ownership. Any bills for maintenance or taxes or repairs are split the same way. Improvements to the property can be paid individually or split among the owners, depending on who feels the improvements are needed. No owner can be made

### (III) Joint Tenancy

Joint tenancy in California always includes right of survivorship and automatic transfer of title to the property. It is based on four unities (discussed below), with one important exception to them that allows owners to convert to joint tenancy later. Special rules apply to selling property held in joint tenancy or using it as collateral for a loan.

(A) **Right of survivorship** - If one joint tenant dies, the other immediately becomes sole owner. If more than two joint tenants are involved, the survivors own the property between them. It cannot be left to a third party (anyone who had not been a joint tenant with the person who died.)

"Right of survivorship" does not have to be mentioned in legal documents on joint tenancy in California, although it can't hurt. (In other states, it may be necessary to mention it.) California does require that the words "as joint tenants" or "in joint tenancy" be in writing. Otherwise the law presumes tenancy in common or, for husband and wife, community property.

(B) **Title transfer** - Title transfer is automatic at the death of a joint tenant. However, proof of death needs to be filed, along with a description of the property and a certificate that shows no inheritance tax is due on it. Proof of death can be in the form of a death certificate, court decree, or testamentary letters.

(C) **Four unities** - The idea of joint tenancy is based on four unities, things that joint tenants share. Joint tenants hold title together, have invested the same amount of time in owning their property, have common interest in and common possession of their property. If one of these four is missing, the law presumes tenancy in common.

(D) **Exception for title** - The California Legislature has made an exception for title. Joint tenants no longer have to acquire title with the same conveyance, provided their intentions are clearly stated in the deed. Therefore, someone who has been sole owner can make another person joint tenant. This is usually done by a title transfer from

following order: (1) to pay off all creditors who are not partners of any kind; (2) to pay all limited partners their share of profits; (3) to repay limited partners for their capital investments; (4) to pay debts owed to general partners (not including capital investments and profits); (5) to give general partners their share of profits; (6) to repay general partners for their capital investments.

(4) **Uniform Limited Partnership Act** - California has adopted the Uniform Limited Partnership Act to cover limited partnerships.

This act defines a limited partnership (as above) and spells out the rights and liabilities of the various partners, both general and limited.

The act also explains the relationship between limited partners, how they may be compensated, how and when a limited partner may withdraw his contribution, how his interest may be assigned to someone else, what affect the loss of a general partner will have on the business, what happens to a limited partner's share when he dies, when and how a certificate for limited partnership can be amended or canceled, and distribution of assets. It also provides that rules of law and equity will govern in any case not specifically provided for.

Provisions of the Uniform Partnership Act (UPA) are still in effect for general partners in a limited partnership business.

#34 (C) **Partnership by estoppel** - A person can be presumed to be a partner if he has conducted business as though he were a partner or he has allowed someone to name him as a partner to a third party. If he has allowed someone to believe he is a partner, he cannot later deny being a partner. He could be held liable for debts contracted by the person who named him as partner, if he was named as partner to the creditors and did not immediately deny it.

This is called "partnership by estoppel." "Estoppel" means that a person cannot later deny something if his words or actions indicate that the opposite is true.

## (II) Corporations

A corporation is formed by a group of people who file a charter, establish by-laws, set up a board of directors, and issue shares of stock. Once a corporation has been established by law, it is a legal entity and has rights just as though it were a person. A corporation may buy and sell land as owner in severalty. It may be sued or bring suit. It conducts

business on its own behalf and may enter into contracts in its own name.

#58 (A) **Setting up a corporation** - Articles of incorporation are filed with the Secretary of State where the company plans to do business. The articles must include an acceptable name, the corporation's purpose, address of its main office, registered agent's name, names and addresses of its incorporators, and information on its capital structure and stock issue.

A corporation's name is very important. It cannot be too much like that of an existing corporation and it must include a word or abbreviation that indicates its corporate status. Examples of appropriate words are "incorporated," "corporation," "limited," and "company."

People involved in setting up a corporation include shareholders, who invest needed capital, and a board of directors to manage its business affairs. Any or all of these people may be involved in writing the original by-laws regulating the corporation. These by-laws can be repealed or amended by shareholders unless those actions are specifically prohibited in the by-laws themselves. All people directly concerned with a corporation — its board of directors, officers, and shareholders — are bound by these by-laws. Those outside the corporation (third parties, etc.) are not.

#59 Liability of shareholders is normally limited to the amount of their investment, and shares of stock are easily transferable by sale, gift, or inheritance. Since stock is personal property, shareholders have no ownership rights in the company's real property.

A corporation exists in perpetuity, i.e., as long as the law permits it to exist. Therefore it can never own property as a joint tenant with right of survivorship. Its existence is not affected by shareholders' retirement or death.

The board of directors passes resolutions on how to handle corporate business. As part of their resolutions, they authorize certain officers to take care of buying and selling corporate property. The company secretary can supply certified copies of these resolutions so those outside the company know with which officers they should negotiate.

By-laws may indicate whether a corporation can buy real property when and where it chooses, or only for specific corporate needs.

(B) **Promoters** - A corporation trying to be born needs a promoter who will look for investors to supply necessary capital and who has the power to sign contracts on behalf

of the future corporation. This includes buying real property for its future use.

The promoter is liable for all contracts he signs until the board of directors of the new corporation ratifies them. Then they become the corporation's contracts and only the corporation can be sued regarding them.

If the board of directors fails to ratify any of the contracts the promoter has signed on behalf of the corporation, the promoter is liable for them. To avoid this possibility, he could see that a clause limiting his liability or absolving him from liability is included in each contract.

The promoter has a fiduciary relationship with the future corporation. Therefore, he must disclose all facts to corporate investors and must act in the best interests of the corporation at all times. He is not permitted to profit at the expense of the investors.

### **(C) Foreign and domestic corporations**

(1) A "domestic corporation" is one that is registered in the state or country where it does business.

(2) A "foreign corporation" is registered in one state or country, but it is doing business in another state or country. It needs to be authorized under local laws where it intends to do business.

### **(D) Types of corporations** - Corporations can be public, quasi-public, or private.

(1) **Public corporations** - "Public corporations" are run by or for the government. Taxes are used to support them.

(2) **Quasi-public corporations** - "Quasi-public corporations" are those that provide some kinds of public service. They generally receive some special privileges so they can better serve the public, but they are also surrounded by many safeguards and regulations to keep them from violating public trust.

(3) **Private corporations** - "Private corporations" are either profit or non-profit.

(a) Profit corporations are in business to make money (earn profits) for their owners (shareholders).

(b) Non-profit corporations are in business to raise money for charity. Members are not liable for debts incurred by a non-profit corporation, which, like a profit corporation, may enter into contracts and buy real estate in its corporate name.

(c) Non-profit associations are unincorporated groups of people involved in such areas as religion, education, science, social service, etc. They may buy real property in the name of their organization, and members are not liable for association debts.

### **(E) Other types of corporations** - Other designations used for corporations include "de jure," "de facto," and "corporations by estoppel."

(1) **De jure corporation** - A corporation has to comply with local statutory regulations to become a legal entity. If it does, it is called a "de jure corporation," one that exists in law.

(2) The law recognizes two kinds of corporations that have not met statutory regulations. They are accepted as corporations only under certain circumstances.

(a) **De facto corporation** - a "de facto corporation" has shareholders who have invested in good faith and tried to organize a corporation. However, in the process of that organization, they failed to comply with some statute. According to the law, this corporation exists in fact, even though it does not exist in law. Therefore creditors cannot hold shareholders liable for the corporation's debts, since they acted in good faith.

(b) **Corporation by estoppel** - This protects the creditor or person outside the business. If a business calls itself a corporation when entering an agreement with a person outside the business, it cannot later get out of the agreement because it is not a corporation. The law will recognize it as a corporation as far as necessary to protect the rights of the other person who was acting in good faith. #61

### **(III) Syndicates**

A real estate "syndicate" buys one property, holds it for a certain period of time, and then sells it. The property normally produces some income while it's held, and a large return when it's sold.

A syndicate has at least two people or firms involved, but it may have many more. Investors pool their money to raise enough to buy the property.

This type of investment is often the answer for someone who doesn't have much to invest and wants a good return for his money. Since real estate syndicates are often run by real estate agents or brokers, this property generally has professional management. Thus the small investor gets a

second advantage, as he couldn't afford to hire a professional manager on his own. He also gets a tax write-off as the owner of real property.

#60 A syndicate cannot own real estate in its own name, but it can organize ownership firms, partnerships, corporations, or trusts to own the real estate. These have various advantages and disadvantages.

(A) **Corporation** - If a syndicate sets up a corporation, it offers the benefits of central management of the property and limited liability on the part of investors. However, corporations are subject to double taxes — once on the corporation's profits, and again on dividends paid to shareholders.

(B) **Joint venture** - A syndicate that sets up a joint venture avoids double taxation, but, as in a general partnership, investors have unlimited liability. Also, since all partners have an equal say, there is no central management for the property.

(C) **Limited partnership** - A limited partnership offers the best of both. It avoids double taxation, since it is a partnership. It provides centralized management and limited liability just as a corporation does. That's why it's the most popular choice for real estate syndicates.

#### (IV) Joint Venture

#65 A joint venture is very similar to a general partnership. It involves two or more people or business groups, with unlimited liability and the tax advantages of a partnership.

#63 There are two main differences between a joint venture and a general partnership. A joint venture is for a single business enterprise; its members have no intention of forming a permanent business relationship. And it has a time limit. The time limit may vary with the enterprise, but it is always included.

#### (V) Real Estate Investment Trust

#64 A Real Estate Investment Trust (REIT) puts together a group of properties, not just one, and sells shares in this package to at least 100 people. Unlike the syndicate, which makes most of its money from selling property, a trust manages its properties to bring in income, the majority of which is divided among its shareholders. A trust that distributes 95% of its money to its shareholders only has to pay corporate taxes on the remaining 5%.

#38 Trusts must get at least 75% of their income from real estate investments. They are not allowed to hold property for the

express purpose of selling it to customers. They may not sell 50% or more of their shares to five or fewer people.

In California, each share also carries a vote in setting trust policies. Those investing in a trust have the same tax benefits they would get from investing in mutual funds.

Trusts offer a number of benefits besides their tax advantages for the investor and the opportunity for a small investor to be involved in big investments. They also have the best legal counseling available and are strictly regulated to protect the investor as much as possible. Because they have a wide variety of real estate in their package, they offer a combination of safe investments and probable high returns.

REIT's come in three forms: equity, mortgage, and combination.

(A) **Equity Trust** - With an equity trust, income is primarily from rent on the package of real property the trust owns. There may also be some capital gains as pieces of property are sold. A trust is allowed to develop property, but since it is for investment only, it does not manage its own properties or provide any services to the tenants of those properties. It uses an "independent contractor" to do that.

(B) **Mortgage trust** - With a mortgage trust, income is generally from interest earned on long-term and short-term mortgages, as the trust uses investors' money to lend to others who want to buy real estate. Short-term mortgages normally run 6-24 months; long-term mortgages are for 20-30 years.

(C) **Combination trust** - Combination trusts are allowed to own, lease, and develop property and to provide money for mortgages and loans. They combine all the money-making potential of both equity and mortgage trusts.

## OWNING AN APARTMENT

A number of people own their own apartment either through a cooperative or by buying a condominium. There are important differences in the two.

### (I) Cooperative

A cooperative is one way a person can own his own apartment. Actually, a corporation or land trust has title to the apartment building and sets a value on each unit. Each

# 4

## CONTRACTS

### INTRODUCTION

Contracts are agreements to do or not to do certain things. They may be oral or written, although some must be written to be considered legal.

Contracts are essential to real estate. This chapter will discuss certain classifications of contracts, their essential elements, performance and non-performance, and some of the more common contracts used in real estate.

### CLASSIFICATION OF CONTRACTS

#3 | Contracts may be classified in a variety of ways. Their legal effectiveness may be valid, voidable, void, or unenforceable.

Their manner of agreement may be expressed or implied. Their content of agreement may be unilateral or bilateral. The extent of their performance may be executed or executory.

#### (I) Legal Effectiveness

**(A) Valid** - A contract is "valid" if it is legal in all respects, binding on both parties, and enforceable (if necessary) by law. It contains the five essential elements (discussed later). It has been signed freely and voluntarily by each party. There has been no fraud, force, or duress used to induce anyone to sign. Most contracts are valid.

**(B) Voidable** - A "voidable" contract appears to be valid, but it could be disaffirmed or rejected. A contract with a minor could be voidable, and so could a contract gained by fraud. A contract signed under duress or undue influence could also be voidable. If the contract is not disaffirmed or rescinded within a reasonable time, it could be considered valid by the courts. However, when con-

tracts are with minors, people under chemical influence, ill or elderly persons, or anyone in great distress, extreme care should be taken by the broker to be sure the contract will be valid and not voidable.

**(C) Void** - A contract that is "void" is not a contract at all. It has no legal effect because it does not meet the essential elements. It does not have to be formally rescinded. Any contract for illegal purposes would be void in court.

**(D) Unenforceable** - A contract is "unenforceable" if there is no way to prove it in court. It may be "valid as between the parties" if they choose to be bound by it. Oral agreements may fall into this category, and so could contracts for which the statute of limitations has passed.

#### (II) Manner of Agreement

**(A) Expressed** - If the manner of agreement is "expressed" in a contract, both parties have stated their intentions in words. This could be written authorization for one person to act as agent for another, or a final sales contract where one party agrees to pay a specified amount of money and the other agrees to convey a certain parcel of real estate. An expressed agreement may also be oral.

**(B) Implied** - If the manner of agreement is "implied," it is shown by conduct or action, not by words. If someone wants to buy a house only if the chimney is repaired, and the seller repairs the chimney without any comment, they have an implied contract for the sale/purchase of that house.

#### (III) Content of Agreement

**(A) Unilateral** - If only one party promises to do something, a contract is "unilateral." Usually, the promisor wants to make someone else do something in return. A

reward is a unilateral promise. Whoever puts up the reward promises to pay whoever performs a certain action, whether it's returning a lost dog, locating a missing child, or providing information leading to the capture and conviction of a criminal. No one has to perform the second action — the reward could go unclaimed. But if someone does bring what's wanted, the reward must be paid (the promise must be kept).

**(B) Bilateral** - If both parties promise to do something, a contract is called "bilateral." It's really an exchange of promises — "you scratch my back and I'll scratch yours." This includes an agreement between Junior and Mom that when he has cleaned his room she will let him watch television. Real estate contracts are bilateral — one party agrees to pay money and the other agrees to transfer title on a piece of property.

Both unilateral and bilateral contracts are binding on those whomake them.

#### (IV) Extent of Performance

**(A) Executory** - A contract is considered "executory" if it has not been completed. Something still needs to be done by one or both sides.

**(B) Executed** - A contract that is "executed" is complete — everything has been done. All promises have been fulfilled.

### ESSENTIAL ELEMENTS

Contracts have five essential parts or elements: they must be between competent parties, be about a lawful object, contain one party's offer and the other's acceptance, exchange a valuable consideration, and, in many cases, be in writing and signed.

#### (I) Competent Parties

Competent parties are of legal age, sane, and capable of understanding what they are signing. Both buyer and seller must be competent.

**(A) Minors** - Legal age in California is 18 or older. Those under 18 — minors — can, while they are still minors or for a reasonable time after they reach legal age, disaffirm or reject contracts made by them while they were minors. A minor's heirs can also disaffirm a minor's contract.

Since a minor cannot enter into a contract, he cannot give power of attorney to anyone, nor can he appoint an agent

to act for him. Any minor involved as a principal in real estate should have a court-appointed guardian overseeing the transaction — for his own sake, and for the sakes of the broker and the buyer or seller. Brokers dealing with minors would be wise to consult an attorney.

Certain minors are, however, allowed to enter into contracts. Under the Emancipation of Minors Act, the following are of legal age even if they are not 18 yet: anyone on active duty with any branch of the U.S. armed forces; anyone who has been legally married, even if the marriage has been terminated; and anyone who has been granted a deed of emancipation by the superior court in his county. Emancipated minors have been legally set free from parental control.

Minors, whether emancipated or not, may inherit property. The court usually appoints a guardian or conservator for them, and they are allowed to mortgage, lease, or convey their property, or to acquire more.

**(B) Incompetents** - A person is considered incompetent and unable to enter into a contract if he cannot understand what he is signing. Various handicaps and illnesses might place a person in this category, temporarily or permanently.

If the courts decide a person is legally incompetent, they can wait for him to recover his capacity, if that is possible, or they can appoint and supervise a guardian who will act on his behalf. This guardian is essential for any real estate dealings while the person is incompetent. Like minors, persons who are incompetent may inherit property. The court usually appoints a guardian or conservator for them, and they are allowed, through the conservator, to mortgage, lease, or convey their property or to acquire more.

**(C) Aliens** - In California, aliens have the same property rights as citizens, whether they live here or not. However, there are some restrictions under federal law.

**(D) Convicts** - Convicts have forfeited certain civil rights while they are in prison, but not the right to own property. While in prison, they may acquire property by inheritance, gift, or conveyance, and they may convey property to others.

**(E) Groups and representatives** - Partnerships, corporations, and non-profit corporations and organizations are all considered competent parties for signing contracts. So is the executor, executrix, or administrator of the estate of a deceased person.



Carelessness on the part of the signer is not fraud. If someone signs a contract, he is expected to have read and understood all of it. He cannot later claim fraud just because he couldn't be bothered to read it before he signed.

If he did not read the contract because someone told him what it said, and that person gave him incorrect and fraudulent information, the court can cancel the contract, or reform it (change it) to show what the parties really agreed to.

No one can absolve himself of fraud by adding a phrase to that effect in the contract.

(c) False representation - Representations are statements of incidental or secondary facts that influence someone to sign a contract. An agent who is guilty of false representation may be liable for damages if the contract limits his authority to make representations.

The innocent party may be relieved of all liability, and the defrauded third party may have the contract rescinded. These actions do not happen automatically, however.

(2) **Undue influence** - When someone has the confidence of another, or authority over him, and uses that influence or authority to gain an unfair advantage, this is called "undue influence." Typical relationships where this might occur are parent/child, husband/wife, guardian/ward, physician/patient, attorney/client, clergyman/parishioner, trustee/beneficiary, and broker/principal.

All of these relationships should mean that one will not act against the best interests of the other, or try to persuade him to act against his own best interests or his own free will. However, sometimes the one with the upper hand will take advantage of the other's needs, distress, illness, or weakness of mind. For example, a daughter caring for a dying father might persuade him to leave his house and money to her and to cut her sister out of his will, by lying about something her sister supposedly had done.

Any contract signed under undue influence is voidable.

(3) **Duress and menace** - These are closely related.

(a) Duress - "Duress" means putting unlawful pressure on a person to make him do something he would not do of his own free will. California law differentiates between duress of persons (the individual and his family), and duress of property. Duress of property means unlawfully keeping possession of it in order to put pressure on the person who owns it.

(b) Menace - "Menace" could be a threat to commit duress, or it could be force, threats of physical violence, or threats against a person's character (threats of character assassination).

(4) **Mistakes** - If both parties have made a mistake about the subject of their contract, or if that subject somehow no longer exists, there is no contract.

If there is a substantial mistake about a basic (material) fact, and one person signed because of that mistake, the contract may be voidable.

(a) Gross negligence - Gross negligence cannot be excused as a mistake. A contract is not voidable because one party did not bother to read what he signed. However, it may be possible for a person to have been mildly negligent about something, to have made a mistake because of it, and to be released from that mistake. It would be foolish for anyone to depend on that, though.

(b) Mistake of fact - A "mistake of fact" has to be important to the contract—has to involve a material fact. It could be that one person believes something exists or used to exist, when it never did. Or it could mean forgetting or not knowing about a material fact. Whichever it was, it is not caused by someone neglecting a duty. The contract may be voidable.

(c) Mistake in law - A "mistake in law" is where all parties to the contract have the same misunderstanding about the law (misapprehension of the law), but they are all certain they understand it perfectly. It can also happen that, when the contract is signed, one person obviously misunderstands a point of law, and the others, who do understand it and are aware that he does not, do not correct him. The contract may be voidable.

#### (IV) **Consideration**

A consideration is what each party will give the other under the terms of the contract. It can be money, a deed, an action, a promise not to do something—whatever the two parties have agreed on. As long as there is a valid consideration, there is a valid contract.

##### (A) Bilateral and unilateral consideration

(1) Bilateral - In a bilateral agreement, each side promises something in consideration for the promise

#67

of the other. For example, Helena's promise to pay \$100,000 is consideration for Katherine's promise to give her the deed to her townhouse. Katherine's promise to deed over her townhouse is consideration for Helena's promise to pay \$100,000.

(2) **Unilateral** - If the contract is unilateral, one person or side promises a certain consideration for something he hopes the other will or will not do. This includes rewards.

(B) **Specific performance** - In a court action asking for "specific performance," the contract must have an adequate consideration, as that will influence the court's ruling. (This action enforces a contract so that each side must carry out the promises it made.) Except for this, size of consideration is not important, as long as it is acceptable to both parties. In some cases, it could be a moral promise. In real estate matters, it could even be a dollar or other nominal amount.

#### (V) Agreement in Writing

#66 Certain contracts must be in writing and signed by all parties concerned in order to be legal. For example, checks, promissory notes, and bills of exchange are valid only when they are in writing.

Real estate contracts that must be in writing include listing agreements, option agreements, sales contracts, escrow agreements, leases, and installment contracts.

#68 (A) **Signatures** - Signatures needed on real estate contracts may include those of buyer, seller, spouse(s), and co-owners. An agent who has proper legal authority may sign for a principal. Corporate officers who sign must also affix the corporate seal.

#69 (B) **Statute of Frauds** - The Statute of Frauds exists to prevent unscrupulous people from taking advantage of others through dishonest conduct, perjury, or forgery. The statute makes certain contracts invalid unless they are written and signed.

#71 Contracts that must be written are listed in Section 1622 of the California Civil Code. These are, by paragraph, the following: (1) an agreement that cannot be completed within one year from when it is signed; (2) a promise to pay off another person's debts; (3) an agreement depending on marriage (except for agreeing to marry); (4) an agreement to lease for more than one year, or to sell real property or any interest in it; (5) an agreement to employ a real estate agent to buy, sell, or lease real property on one's behalf, for a commission; (6) an agreement that will not be completed

until after someone's death, such as a will; (7) an agreement to secure a mortgage or trust deed to finance the purchase of real property.

The actual statute's paragraphs are longer and more detailed. In Paragraph 4, it provides that almost every contract related to real estate must be in writing.

Paragraph 5 allows a real estate agent to collect a commission as long as he has a contract in writing with the property owner. If he does not have it in writing, it is unenforceable, no matter how many witnesses he may have to an oral agreement.

## PERFORMANCE OF CONTRACTS

Contracts are performed when they are fully carried out, but they may have built-in time limits, and one or both parties may change the contract or the people involved.

#### (I) Time

Some contracts must be performed by a specific time or date or before a certain event. Other contracts say "time is of the essence" so that they will be performed as quickly as possible.

Any contract that does not have such a time built into it must be performed within a reasonable period of time, which is determined by individual situations. If any parts of the contract can be performed immediately, they should be, unless both parties agree otherwise. For example, money can probably be paid immediately.

If a contract must be paid by a date that turns out to be a holiday or weekend, the contract is automatically extended to the next working day/non-holiday. "Holidays" include all those listed in the Government Code and may include days that banks and public offices are closed.

#### (II) Changes

Sometimes after a contract has been signed but before it is fully executed, one party may wish to withdraw without terminating the contract. This can be done by "assignment" or "novation."

(A) **Assignment** - Unless specifically forbidden, a contract can usually be assigned to someone else if one of the parties wants to drop out without canceling it. "Assignment" involves transferring all rights and duties under a contract to another person. However, if the contract was for some special ability or unique quality of that person, it cannot be assigned.

Since assignment may or may not be acceptable to the other original party, there is usually a clause in the contract to permit or forbid assignment.

The person who assigns his rights is the "assignor." The person to whom he assigns them is the "assignee."

The assignor may have obligations to transfer, also. If so, he is known as the "obligor," the one who owes a duty to another. Along with his rights, he can transfer these obligations to the assignee, who is then also known as the "new obligor."

The assignee/obligor still has secondary liability to the "obligee," the person with whom he originally had a contract and the one to whom he had a duty or obligation. That means that if his assignee/new obligor does not perform these obligations, the assignor/obligor must still do them, unless the obligee specifically releases him from their performance.

#70  
**(B) Novation** - "Novation" means substituting a new obligation for one that already exists. The substitution is intended to extinguish (cancel) the old obligation.

Sometimes the old obligation is kept, but there is a "novation of parties" — a change in people. This occurs most often when one person takes over another's debt, as, for example, when a buyer assumes the seller's existing mortgage. The debt is not canceled, but there is a change in who will pay it and perhaps in how it will be paid.

Since a novation is really a change in contract, it must contain all the essential elements of a contract and include a consideration. Its form does not matter as long as the content is complete.

## DISCHARGING A CONTRACT

To discharge a contract is to cancel it. Often that is done by "full performance" — all terms are completely carried out. Sometimes the contract is "breached" (broken). In between the two extremes are a wide range of possibilities.

### (I) Contract Not Fully Performed

**(A) Part performance** - "Part performance" or "partial performance" means that the contract has not been completed. The one to whom some money or duty is still owed writes an acceptance of the situation, canceling the debt.

**(B) Substantial performance** - One party has completed most of the terms of the contract — has "substantially performed" it — enough so that a court could order payment to be made. Usually there is some adjustment for damages to the other party.

**(C) Impossibility of performance** - One of the acts in the contract cannot be done because it is illegal. The problem must be with the act itself and not with the person who is supposed to perform it.

**(D) Agreement** - Both parties agree to cancel the contract.

**(E) Release** - One party frees (releases) the other from the terms of the contract.

**(F) Operation of law** - The contract is voided by the courts due to fraud or undue influence or because it was with a minor, or the statute of limitations has expired, or the contract was altered without everyone's consent in writing.

### (II) Breach of Contract

"Breach of contract" occurs when any condition or term of a contract has been violated without legal excuse.

If the buyer defaults, the seller can declare the contract forfeited and usually keep all money paid so far.

Sometimes the breach is accepted because one party feels it is not worth going to court over the matter — the amount to be reclaimed may be too small or the other party may not have assets enough to pay damages.

Sometimes the victim decides to sue the defaulting party. Suit can be for rescission, specific performance, or damages.

**(A) Rescission** - ~~To rescind a contract is to put everything back the way it used to be, as though the contract had never existed. When one party has defaulted, as in breach of contract, the other may unilaterally rescind.~~ #74

This rescission must be free from duress or undue influence and must be done as soon as possible. Everything of value one has received from the other must be returned, including earnest money and any payments. If both sides have exchanged things of value, one side may offer to restore them if the other will do the same. This is sometimes referred to as "rescission and restitution."

Sometimes rescission can be handled between the two parties and sometimes it goes to court. A court judgment

may require the defaulting party to pay damages to the other party, to compensate for the breach.

**(B) Specific performance** - "Specific performance" means the contract will be carried out. When the contract involves land — title, rights, or interest — the law may order specific performance because every piece of land is considered unique. Therefore, money cannot adequately compensate for it.

# 72  
If a real estate sales contract (deposit receipt) is signed, it is specifically enforceable. So is an option when a consideration has been given. Either side can sue for specific performance on an option, and the optionee can sue whether he signed the contract or not.

# 73  
Some contracts are not specifically enforceable. These include personal service, illegal acts, getting a third party's consent to something, and contracts that are vague or imprecise.

Specific performance can only be enforced if the consideration is adequate. This means it has to be fair and reasonable according to the circumstances. It also means the seller has to be reasonably sure of receiving the consideration and the buyer has the right to a merchantable title (one that's free from doubt).

**(C) Damages** - Punitive damages for breach of contract are rare unless "bad faith" can be proven. Most damages for breach of contract are reasonable compensation for "detriment." Detriment could be the price paid, if the seller has paid but has not received title. In a purchase agreement, detriment is usually the amount due the seller above what the property is worth to him.

Some deposit receipts and sale or lease contracts have forfeiture clauses that spell out the amount of damages to be paid in case of breach of contract. This is called a "liquidation damages clause." The law on this has changed drastically.

(1) **Old law** - Under the old law, which affects any contract written before July 1, 1978, the liquidated damages clause is considered invalid. Whoever wants to enforce the clause would have to prove that actual damages were difficult to determine at the time the contract was written and that the amount stated in the clause is reasonable and fair.

# 75  
(2) **New law** - Under the new law, which took effect on July 1, 1978, and covers all contracts from then on, the liquidated damages clause is considered valid. If one party wants to invalidate the contract, or that clause, he

must prove the amount stated in it is unreasonable and unfair.

(3) **Exceptions** - There are, of course, exceptions to the rule, and they are important to real estate.

(i) **Personal property** - If someone has purchased or rented personal property or contracted for services that will be used by him, by his family, or at his home, the old rule applies. Liquidated damages charges cannot be collected from him unless they can be proved reasonable.

(ii) **Real property** - If someone has leased real property so that he or his dependents could live in it, the liquidated damages charges are again invalid and cannot be collected from him unless they are proved reasonable.

(iii) **Construction** - Special rules apply to liquidated damages clauses in construction contracts with certain government agencies. These contracts often specify an amount to be paid for each day of delay in construction. This would be valid unless the amounts could be proved unreasonable.

(iv) **Special rules** - Special rules apply to liquidation damages charges when buying and selling real property. These will be discussed later, under Real Estate Contracts (this chapter).

**(D) Tender** - If closing day arrives and only one party is ready to close title and conclude the contract, that party should make a "tender" or offer of what he said he would do (seller offers the deed, buyer offers the money) and ask the other party to do what he said he would do.

If the person to whom the tender is made has any objections, he must say what they are at this time, or his objections are waived.

If one side makes a tender and the other side cannot fulfill its part of the bargain, the one that cannot carry out its bargain is in default (guilty of breach of contract).

**Statute of Limitations** - If the statute of limitations for a contract has expired, the law cannot enforce that contract. Various types of actions have different limitations, from 90 days to ten years. Action does not have to be completed before the statute of limitations runs out, but it does have to be filed. It begins when filed.

Some limits that apply in real estate are as follows.

(1) **Ninety-day limit** - for civil actions to recover property left at any rented lodging or hotel. Time is

most often used to convey property, but transfer can also be by warranty deed, quitclaim deed, or bargain and sale deed. Whichever is used, it must have all the essential elements of a valid contract.

**(A) Grant deed** - A deed must use certain terms to indicate that property is being conveyed (transferred) from one party to another. In a grant deed, the word "grant" is part of the phrase used to convey title. The person selling, or transferring ownership in, the property is the "grantor." The person buying, or receiving ownership of, the property, is the "grantee." A grant deed will transfer both current title and any "after-acquired" title to the property. That is, it transfers whatever interests the grantor has at the time the deed is signed plus any interest he may get in it at some future date.

A grant deed has implied warranties, or implied guarantees. By its existence, it implies that the grantor has not already given or sold this property to anyone else. It also implies that the property is free from encumbrances and liens, unless they are stated in the deed. It is not a warranty (guarantee) that the grantor is the legal owner of the property. In other words, a grant deed does not promise that the person signing it is legally entitled to grant that property to someone else.

**(B) Warranty deed** - Warranty deeds guarantee title, that the grantor is the legal owner, and that the property is free from encumbrances. They are not used much in California, which relies heavily on title insurance companies to guarantee title.

**(C) Quitclaim deed** - A quitclaim deed has no implied warranties. It transfers whatever interest the grantor may have in the property at the time it is signed, but not any "after-acquired" title. The quitclaim deed transfers title "as is." It makes no guarantee about the quality of the title or of the grantor's claim to the title.

Quitclaim deeds are often used to clear "clouds on the title" such as misspelled names and other minor defects.

**(D) Bargain and sale deed** - A bargain and sale deed states the consideration and implies that the grantor has the right to transfer title in the property. It contains no warranties against defects in the title or against encumbrances.

If the bargain and sale deed contains a "covenant against the grantor's acts," then it warrants that the grantor has done nothing to cloud the title.

**(E) Trust deeds** - Trust deeds are really liens, with the property held in trust as security for a debt. The "trustor" (borrower) conveys legal title to the "trustee" (third party), who holds the property in trust for the beneficiary (lender). If the trustor fails to pay the debt, the trustee sells the property and pays the beneficiary.

The trustee has only the legal title until the trustor defaults. The trustor still holds the "equitable title" and can do as he pleases with the property, unless his actions would interfere with the beneficiary's interest.

### (III) Legal Action

Title can be transferred, voluntarily or involuntarily, by a number of legal actions.

**(A) Marriage** - Anything acquired or earned during the marriage by either husband or wife belongs to both, according to California's laws of community property. The only exceptions are property that is specifically given to one or the other spouse, and earnings or property acquired by either while they were separated. Property acquired before marriage remains the property of that spouse, unless he or she behaves as though it were community property.

**(B) Bankruptcy** - When a person files for bankruptcy, all his property goes to court-appointed trustees. These trustees sell the property and pay the creditors as much as possible from the proceeds.

**(C) Forfeiture** - Property that has been sold as "condition subsequent" may be forfeited if that condition is breached.

Property that is conveyed with "special limitations" is forfeit once the limitations are no longer in effect. Thus, if the deed was good until a certain event took place, once that event takes place title reverts (goes back) to the original owner (the grantor who imposed the special limitations) or his heirs.

**(D) Escheat** - If no one is available to inherit property legally, it goes to the state by "escheat." The term means that the state is the original legal owner of land within its borders.

**(E) Execution sale** - When a legal judgment against a property owner can be paid in no other way, the courts may seize his property and sell it at execution sale. Proceeds from this go to satisfy the judgment.

The buyer at an execution sale does not receive immediate title. He receives a certificate of sale, but the previous owner

normally has twelve months in which to redeem his property. If the property is not redeemed within that time, the execution buyer receives clear title to the property.

(F) **Eminent domain** - The government can take property by eminent domain if the property is to be used for the benefit of the public. This will be discussed at greater length in Chapter 12.

#76 (G) **"Quiet-title action"** - "Quiet-title action" means clearing or "quieting" the title by removing clouds, liens, titles based on adverse possession, and titles under a forfeited sale contract.

(H) **Partition action** - When one owner of property wants his share of the proceeds and the property cannot be easily divided, the courts can sell it and then "partition" or divide the proceeds among the owners.

#78 (I) **Foreclosure** - If someone has a lien on property and cannot collect from the owner, he may ask the courts to foreclose on the property. They then seize the property, sell it, pay the lien, and give the rest back to the original owner. This happens most often when the owner cannot or does not pay his mortgage or when there is a mechanic's lien on the property.

#85 (J) **Declaratory relief action** - In the case of oral declarations, deed restrictions, homesteads, or other controversial titles, the courts may be asked to decide who actually has title before the parties take further action. The court decision is a "declaratory relief action."

#87 (K) **Equitable estoppel** - If justice is better served by leaving title with a new owner than by restoring it to a former owner, the courts may transfer title by equitable estoppel.

## OCCUPANCY

Transfer of ownership can occur when property is adversely occupied by someone, when it is taken by prescription, or when it is abandoned.

### (I) Adverse Possession

#88 If someone other than the legal owner takes possession of the property without the owner's permission, and lives there openly for at least five years, claiming to be the owner and paying property taxes for those five years, that person can become the owner by adverse possession.

The person claiming ownership by adverse possession may have had others living on the property — family or tenants — instead of living there himself. He must have improved the property in some manner or fenced the area he claims.

This provision exists because the law recognizes the importance of using land, as opposed to merely owning it.

### (II) Prescription

Easements can be created by prescription, which means by using someone else's property without permission on a regular, long-term basis. It is similar to adverse possession, but gives an interest in the property without conveying title.

### (III) Abandonment

Not using property is not the same as abandoning it. Abandonment means voluntarily giving up possession of property with the intention of ending one's interest in it. The landlord then recovers his interest in the property.

## ACCESSION #82

Property is acquired by accession when it is added to someone's land by someone or something else.

### (I) Improvements in Error

If someone mistakenly and in good faith improves land belonging to someone else, that person may pay damages and remove the property. This is a change from previous laws.

### (II) Addition of Fixtures

If someone adds fixtures to someone else's property without having a written agreement allowing them to be removed later, those fixtures become the property of the legal owner of the land.

### (III) Accretion

Property owners whose land borders on some body of water (lake, river, etc.) may acquire property by "accretion." That is, the water deposits soil and rock which accumulate and become part of the property. This land increase is called "alluvion".

If the water recedes drastically, as when a river dries up or changes course, the accession of land is said to be by "reliction".

#84

The opposite can occur. When land is slowly worn away by natural causes, it is called "erosion". If it is torn away, as by an earthquake or tidal wave, it is called "avulsion".

With community property, one half belongs to the surviving spouse. The deceased person (decedent) is entitled to dispose of the other half by will. If there is no will, that half normally goes to the surviving spouse, too.

## WILL

A will is a legal means of disposing of property after one's death. It does not have any effect on that property during a person's lifetime.

Property other than community property is often divided equally between a surviving spouse and an only child, or with one-third to the surviving spouse and the rest split between the children of the deceased person.

The courts may require "proof of heirship" to determine who is eligible to inherit when the deceased left no will.

#77

California law recognizes three types of will: nuncupative, holographic, and witnessed.

## SPECIAL BROKERAGE RELATIONS

### (I) Noncupative Will

A nuncupative will is an oral declaration to witnesses, given when a person expects to die very soon. It may dispose of personal property only. This type of will is rarely used.

Sometimes a broker will be called on to sell property in order to help settle the estate of a deceased person. This is a "probate sale." At other times, the broker may be asked to sell property belonging to the State of California or to a local school board.

### (II) Holographic Will

A holographic will is entirely in the person's own handwriting and is dated and signed by that person. It is a legal document.

### (I) Probate Sale

The executor or administrator of an estate can arrange to sell property belonging to that estate. All such sales are subject to confirmation by the probate court.

### (III) Witnessed Will

A witnessed will is signed by the person who is creating it to dispose of property. That person's signature is attested to, or witnessed, by two others who are not beneficiaries of the will, and who sign as witnesses. Everything is dated. This type of will is usually prepared by an attorney.

The property being offered must have been appraised within one year of the date of sale. The purchase price offered must be at least 90% of that appraised value.

### (IV) Probate

When a person dies, a "petition for probate" can be filed with the court to verify distribution of his property (estate). The executor or executrix named in the will, or a court-appointed administrator or administratrix, pays the deceased person's debts and taxes out of the estate, accounts for all money spent, and turns the remainder over to the heir(s). The executor has the power to sell property belonging to the estate to settle debts.

After an offer is received, the probate court sets a hearing date to consider that offer. At the hearing, others may bid on the property. The initial bid has to be a mathematically calculated amount based on the existing purchase price: at least 10% of the first \$10,000 plus 5% of the rest of the bid over \$10,000. However, once that bid has been accepted, bidding can continue in raises of any amount the court will allow. The court will confirm sale to the "highest and best" offer.

Anyone offering a bid on the property, including the initial offer to purchase, should be in court for the hearing and should be accompanied by his broker. Both should be familiar with regulations concerning this bidding, what deposits are required, and so on.

## SUCCESSION

If a person dies "intestate," which means without making a will, the law determines who will succeed to his property. This is called "intestate succession."

The listing broker and the broker who brings the initial bid must have agreements in writing if they are to receive commissions. Any broker involved in the sale should make sure the court knows he is licensed. The broker representing a successful overbidder gets a commission of up to half the difference between the initial offer and the accepted overbid.

## CREATION OF AGENCY RELATIONSHIP

#79

the employer-employee relationship. An ordinary employee, or servant, is defined in the Labor Code as one employed to render personal services to the person's employer, otherwise than in pursuit of an independent calling, and who, in such service, remains entirely under the control and direction of the master. A servant works for his or her master, while an agent not only does this, but acts for and in the place of the principal for the purpose of making contracts and thus bringing the principal into legal relationships with third persons. For purposes of the Real Estate Law, a real estate salesperson is an agent of the real estate broker under whom he or she is licensed. If the broker is a corporation, the salesperson is an agent of the corporation, not of the supervising qualifying broker.

#94

**Independent Contractor.** An independent contractor is one who, in rendering services, exercises an independent employment or occupation and is responsible to the employer only as to the results of his or her work. An important factor in establishing one as an independent contractor is that the individual determines the method of accomplishing the work for which the individual has contracted.

Real estate brokers are almost always independent contractors. Under the law of agency a real estate broker is ordinarily deemed a special agent who deals in the name of the broker's principal, but does not have custody and control of the subject matter of the agency.

**Real Estate License Law.** This subject is discussed in detail in a separate chapter, but it is appropriate here to mention that for purposes of the Real Estate License Law — and this is of primary importance to the licensee — salespersons are employees of the broker as a matter of law and cannot be independent contractors. A contract between a salesperson and his/her broker in which the salesperson is characterized as an independent contractor does not make it so under the Real Estate Law.

**Interrelating Factors.** An independent contractor is a person who sells final results rather than time and whose methods of achieving those results are not subject to the control of another. The independent contractor agrees to do the work contracted for in his or her way. An independent contractor may, however, be an agent. The real estate broker is usually in this category. On the other hand, office personnel are not independent contractors. Further complicating a clear understanding of the above classifications is the fact that there are many independent contractors such as building subcontractors who are not agents at all.

The relationship of principal and agent can be created by agreement (with or without a written contract), by ratification or by estoppel. Normally, however, the status of real estate agent is created by express contract. When created in this manner, the basic principles of contract law are applicable.

**Consideration.** Consideration is not essential to the creation of an agency. One may gratuitously undertake to act as an agent and will still be held to certain standards demanded of an agent for compensation. Generally, however, there is a contract with consideration from the real estate broker and principal. Under the Real Estate Law, acts must be performed for or in expectation of a compensation in order for a licensed agency to exist. When the principal signs a listing contract promising compensation for service by an agent and the agent renders the service requested, the contract is described as unilateral.

When the broker makes a counter-promise in the listing agreement to "use due diligence" in finding a purchaser it is a bilateral contract in that the consideration is a promise for a promise.

An agreement authorizing or employing an agent or broker to purchase or sell real estate for compensation is unenforceable unless the agreement, or some note or memorandum thereof, is in writing and subscribed by the party to be charged or by the party's agent.

This is a logical application of the "equal dignities" rule which states that to be enforceable the authority to enter into a contract required by law to be in writing must also be written. There are certain exceptions, however, as where the agent acts in the immediate presence of the principal and executes the instrument under the principal's direction.

Another exception is sometimes made in circumstances where an agent is an executive officer of a corporation, but this is only in limited cases where the making of the contract is within the scope of the officer's authority. These requirements are in general based upon the English Statute of Frauds which, in modified form, is applied in most, if not all, American jurisdictions.

**Employment Contract.** Thus the first act that takes place between broker and client is the written contract of employment. Although this transaction between the parties would seem to be the most simple phase of the entire relation, it has



nevertheless been one of the greatest sources of litigation.

The duty to know the proper employment procedure is placed upon the broker. A broker draws clients from all walks of life and it is incumbent upon the broker in view of the broker's knowledge and expertise to see that the employment relationship is created in correct form and in a fair manner according to the circumstances.

## AGENT'S AUTHORITY

The following is a brief and general summary of the "law of agency." Some of the material has limited application to everyday real estate transactions, but the general principles should nevertheless be understood.

The Civil Code provides that every agent has authority:

#88 (1) To do everything necessary, or proper or usual in the ordinary course of business, for effecting the purpose of the agency;

(2) To make representations as to facts involved in the transaction in which the agent is engaged.

The authority of an agent may be actual or ostensible. Actual authority is that authority a principal intentionally confers upon the agent, or intentionally, or by want of ordinary care, allows the agent to believe that he or she possesses. Ostensible authority is that authority a principal intentionally, or by want of ordinary care, causes third persons to believe that the agent possesses.

The principal is liable to persons who have sustained injury through a reasonable and prudent reliance upon the ostensible authority of an agent. The act or declaration of the agent can never alone establish ostensible authority, but silence upon the part of the principal who knows that an agent is holding himself or herself out as vested with certain authority may give rise to liability of the principal.

When the principal executes and entrusts to the agent a negotiable or non-negotiable instrument containing blanks and the agent fills them in, the principal will be bound to third persons who rely upon the instrument, even though the agent was not so authorized.

### Emergency Broadens Authority

An agent has expanded authority in an emergency, including the power to disobey instructions where it is clearly in

the interests of the principal, and where there is no time to obtain instructions from the principal.

### Restrictions on Authority

An agent who is given the power to sell and convey real property for a principal also possesses the power to give the usual covenants of warranty unless there are express restrictions in this regard in the agent's agreement with the principal.

The Civil Code expressly states that an agent can never have authority, either actual or ostensible, to do an act which is known or suspected by the person with whom the agent deals to be a fraud upon the principal. Unless specifically authorized an agent has no authority to act in the agent's own name unless it is in the usual course of business for the agent to do so.

#95 An agency to sell does not carry with it the authority to modify or cancel the contract of sale after it has been made. A mere agency to sell property ordinarily empowers the agent to find a purchaser but does not authorize the agent to enter into a contract to convey on behalf of the principal. Unless otherwise specified the authority to sell only permits a sale for cash and the agent is not entitled to accept goods in payment.

An agent who has authority to collect money may endorse a negotiable instrument received in payment only where the exercise of this power is necessary for the performance of the agent's duty. Where an agent is expressly authorized to collect money, the agent may accept a valid check and the agent's receipt of the check will be considered payment to the principal.

An agent who negotiates a loan on behalf of a lender-principal ordinarily has no authority to collect from the borrower except in those instances where the agent has possession of the security and the borrower has knowledge of this fact.

### Ratification of Unauthorized Acts

Occasionally a person may act as agent without any authority to do so, or the true agent may act beyond the scope of the agent's authority. The alleged principal is not bound by such acts. However, a principal may under certain circumstances ratify the acts of the agent and thus become bound. Not only must the principal intend to ratify, but:

(a) The agent must have professed to act as a representative of the principal;

## DUTIES OF AGENT TOWARD PRINCIPAL

Although there may be a custom in real estate transactions for a broker to accept a check instead of cash as a downpayment, the existence of such a custom does not justify the acceptance of a promissory note in lieu of cash unless there is a full disclosure to the seller. While checks are universally accepted as the equivalent of money in business transactions, promissory notes are not. The maker of a check represents that the maker has money in the bank to cover it and the failure to have such money may be a crime. The maker of a note makes no such representation and the maker's failure to pay is not a crime. It has been held under the criminal law of California that a post-dated check is the equivalent of a promissory note.

**Promissory Note.** A real estate broker, like a trustee, has an affirmative duty to disclose all material facts which might influence a principal's decision. Thus the broker who represents by implication that the broker has received cash from a purchaser as a downpayment when in fact the broker has accepted a non-negotiable promissory note has violated the Real Estate Law.

**Escrow Deposit.** In those cases where a downpayment has been paid by the buyer directly into escrow under the standard form of escrow instructions which provide for the exchange of money and a deed on stipulated conditions, the buyer retains title to the money until the conditions have been performed. When the buyer and seller have each performed under an escrow agreement, the escrow holder becomes the agent of the seller as to the purchase money and the agent of the buyer as to the deed.

**Commingling.** The agent who places a client's money in agent's personal bank account is guilty of commingling and creates a risk of having it attached for personal claims against the agent (Business and Professions Code Section 10176(e)). Hence, real estate licensees are required by law to immediately place all funds received on behalf of principals in a special trust account, unless they place them in a neutral escrow depository or in the hands of the principal who is entitled to them. Checks must be deposited for collection by the next business day following receipt by the broker. If the broker fails to do so, the broker is liable to disciplinary action by the commissioner. A salesperson should immediately deliver all deposits into the hands or into the control of salesperson's broker, or as instructed by the broker.

### Loyalty as a Fiduciary.

A real estate agent owes a loyalty to the agent's client and is prohibited from personally profiting by virtue of the agency except through the receipt of the agreed compensation for services. This fiduciary obligation of the agent to a client throughout their dealings is probably the most significant aspect of their relationship. The courts have consistently equated the duty of an agent to a principal with the duty owed by a trustee to a beneficiary. #2

The Civil Code provides that, in all matters connected with a trust, a trustee is bound to act in the highest good faith toward trustee's beneficiary and may not obtain any advantage over the latter by the slightest misrepresentation, concealment, duress or adverse pressure of any kind.

An agent may not unite the agent's personal and representative characters in the same transaction. The act of an agent within the scope of the agent's authority is the act of the principal. In exercising that authority the agent is dealing with property or other matters of grave concern to the principal. The agent has the principal's confidence and is therefore not permitted to enjoy the fruits of any advantage which the agent might take of this confidential relationship. As a fiduciary, the agent in relations with the principal is bound by law to exercise the utmost good faith, loyalty and honesty.

**Fair and Honest Dealing.** A real estate licensee who is the agent of a seller owes a duty of fair and honest dealing to the buyer. This is a duty which the courts have held to exist by reason of the agent's status as a real estate licensee. The duty may also be found to exist by way of the agent's fiduciary obligation to the seller since any misrepresentation or material concealment on the part of the agent may afford the buyer grounds upon which to seek rescission or damages from the seller. An agent must not withhold from a prospective buyer material facts regarding the property which are known to the agent and unknown to the buyer and unascertainable by the buyer through diligent attention or observation. For example, in "Reed v. King (1983) 145 Cal.App.3d 261, seller and his agent were held to have a duty to disclose to buyer that murder had taken place on the property in question ten years earlier.

**Disclosure Duty.** In a fiduciary relationship it is the duty of the agent, in whom such trust and confidence are reposed by the agent's principal, to make full disclosure of all material facts relating to the subject matter of the agency.

### **Obligations of Real Estate Salespersons.**

A real estate salesperson to the same extent as the salesperson's broker is subject to the obligations arising out of the fiduciary relationship between the broker and the broker's principal. The salesperson is the agent of the broker and is employed to carry on licensed activities on behalf of the broker. In performing these acts for which a license is required, the salesperson must disclose to the broker's principal all of the information salesperson has which may affect the principal's decision in a transaction involving the principal.

A failure on the part of the salesperson to fulfill this obligation could result in disciplinary action against the salesperson's license. Moreover, the broker could be held liable in damages to the principal for acts and omissions of the salesperson under the doctrine of respondent superior. Since the broker may be subject to administrative disciplinary action or civil liability for the acts of broker's salespersons, the broker should take particular care in instructing salespersons on their duties and obligations to the broker's principals. The salespersons should also exercise the greatest care in carrying out these instructions of the broker in dealing with the broker's client.

A real estate salesperson is also subject to the proscriptions of the Real Estate Law against dual agency, secret profits and other acts and omissions which violate an agent's duties to the agent's principal.

### **Duties and Liabilities of Agent Toward Third Party**

There are a number of considerations with regard to third parties which should be mentioned, and most of them are in the same vein as those concerning the agent/principal relationship. For example, as concerns the warrant of authority, the agent must take care not to claim to a third party an authority not warranted by the principal.

In addition, the agent should take care concerning contracts whether he or she has any personal liability to the third party. Also the contract should contain, for the third party's benefit, the name of the principal.

Torts are private wrongs committed upon the person or property of another and arising from a breach of duty created by law rather than by contract. An agent is always liable to third parties for the agent's own torts whether the principal is liable or not, and in spite of the fact that the agent acts in accordance with the principal's directions.

A misrepresentation to a prospective buyer (third party) of the lowest price acceptable to the owner is not usually actionable because it's not a representation of a material fact.

An agent must take care not to misrepresent either fraudulently or by negligence. Both are likely to subject the agent to discipline and/or damages.

In addition to making false or misleading misrepresentations to third parties, the agent may err by nondisclosure of material facts. Nondisclosure may also lead to disciplinary action or civil liability.

In recent years there appears to be a growing tendency on the part of the courts to treat "puffing" or "sales talk" as representations of material fact. The agent, therefore, must be careful when making such statements to third parties as: "This is the best house on the block," or "This house is in perfect shape."

### **RIGHTS OF AGENT AGAINST PRINCIPAL**

Generally, to be entitled to a commission the broker must (1) produce a buyer ready, willing and able to purchase upon the terms and at the price stipulated by the seller or (2) secure from the prospective buyer a binding contract upon terms and conditions which the seller subsequently accepts.

From the broker's standpoint, a listing agreement is very much result oriented. The broker's right to a commission is in no way dependent upon, nor is it affected by, the amount of work put into finding a buyer ready, willing and able to purchase and in the "meeting of the minds" of buyer and seller. #16

It is important to remember, as regards the rights of the agent against the principal, that the payment of a commission under a listing contract may be made dependent upon any law condition. A seller may be relieved of the obligation to pay a commission if it appears from the language of the contract that the payment of a commission was contingent upon the happening of a condition that did not occur.

If a broker performs within the time limit specified in the listing, the broker is entitled to commission. In other words, it is well settled that a principal cannot discharge an agent pending negotiations by the agent with a prospective customer, then effect a sale to the customer, without liability to the agent.

**Termination of Agency.** Ordinarily an agency may be terminated by the acts of one or both of the parties or by operation of law. An agency is also terminated by the expiration of its term, extinction of its subject matter, or the death or incapacity of either principal or agent.

# 6

## FINANCING

### INTRODUCTION

This chapter is a brief overview of real estate financing. It includes explanations of the different lending instruments available for financing purchases of real estate, as well as a description of primary and secondary mortgage markets and government agencies involved in real estate financing.

The broker needs to know different ways of obtaining mortgage money, because real estate transactions cannot be completed if the buyer cannot locate financing.

### LENDING INSTRUMENTS

Anyone borrowing money to finance the purchase of real estate will normally sign a mortgage, trust deed, or promissory note.

#### (I) Promissory Note

#36  
A promissory note represents a promise by the borrower (also known as the "maker" or "payor") to repay money he has borrowed from the lender (also known as the "payee"). The note normally states the amount of money borrowed, how and when it will be repaid, and the rate of interest being charged for it.

Since real estate involves large sums of money, the note will usually call for installments of the same amount to be paid at regular intervals, often monthly. The installments will include interest as well as payment on the principal.

Notes related to mortgages will name the mortgage lender as "payee." Notes for trust deeds may be made payable to "bearer," which means that they are payable to anyone who has possession of them and presents them for payment.

All parties involved in borrowing on a mortgage or trust deed should sign the note as well.

Notes can be payable "on demand" or be "time notes." Those payable on demand must be paid whenever they are presented for payment. Current trends seem to be toward "demand plus notice," meaning the payee notifies the borrower a few days ahead of when the note will be presented for payment. "Time notes" cannot be presented before a specified day, but may be presented any time after that.

Notes are said to be "negotiable." That means they can be sold or transferred. To qualify as negotiable, notes must be in writing, made payable by one person to another specific person or to a specific institution or to bearer, be signed by the maker, be for a certain sum of money, and be unconditional promises to pay either on demand or at a future time that is either fixed in the note or easy to determine.

If the note is transferred to someone other than the person named in it as payee, it must be endorsed by the payee as payable to the new person holding it. This new person is referred to as the "transferee" or the "holder in due course."

Checks are the most common form of negotiable note, but any negotiable note can be sold or transferred.

#### (II) Trust Deeds

A trust deed is a three-party instrument involving the lender, the borrower, and a stakeholder. The lender is the "beneficiary" for whom the estate is being held. The borrower is the "trustor," and the third party is the "trustee." The trustee is entitled to charge appropriate fees for his services.

One of the chief differences between trust deeds and mortgages is legal title to property. A mortgage is considered a lien, so the borrower has legal title. With a trust deed, the beneficiary is the legal owner and the trustee holds the

property in trust for him. That is, the trustee holds legal title to the property for the benefit of the lender. The trustor (borrower) has equitable title and possession of the property.

The contract with the trustee tells what procedures he is to follow if the trustor defaults on the loan. Foreclosing on trust deeds is usually faster and easier than foreclosing on mortgages. There is no statute of limitations on a trust deed as legal title is held by the trustee. If the borrower (trustor) is in default on loan payments, he is allowed to reinstate his loan by paying everything he owes up to that time, including costs and fees. This must be done within three months of when notice of default is filed. He has no right of redemption if the property is sold, since he had 90 days in which to reinstate the loan.

When a loan secured by a trust deed has been paid, the beneficiary requests the trustee to reconvey the property to the trustor.

### (III) Mortgages

A mortgage is a lien on property; the owner has used it for security on a loan: If he fails to repay the loan (defaults), the property is sold and the loan paid from the proceeds. A first mortgage is really a first-lien mortgage, and it has precedence over any lien placed on the property at a later time. A second mortgage (second-lien mortgage) may not be paid at all on a foreclosure, if the first mortgage takes all the proceeds.

People often take one mortgage to cover the main cost of the property and another to cover the down payment. Which mortgage is first and which is second depends on when they are recorded, not on which is larger.

Home mortgages are usually written for long periods of time, such as 25 or 30 or even 40 years. However, they are often refinanced, or prepaid when the property is sold, so many are on the books only 7 to 10 of those years.

#32  
Mortgages involve two parties, a "mortgagor" (borrower) and a "mortgagee" (lender). The mortgage is a document putting a lien on the borrower's property in favor of the lender. The mortgage is accompanied by a promissory note, in which the borrower agrees to repay the loan. All details of repayment are included in the note. In order for the loan to be enforceable, both mortgage document and promissory note must be executed.

If payment is not made, the lender has four years in which to institute foreclosure proceedings. Otherwise the statute of limitations runs out. Foreclosure is the only means by

which the lender may recover his money if the borrower defaults.

The loan may be reinstated at any time, as long as the borrower makes all payments due up to that time and pays all additional costs and fees. This can be done at any time before foreclosure becomes final, and may be done by the mortgagor or his successor, by anyone holding another mortgage or trust deed on the property, or by anyone having another lien or encumbrance on the property.

The borrower or his successor may redeem the property if it was sold subject to redemption, which is based on a law that became effective July 1, 1983. Any foreclosures prior to that are governed by the laws in effect when foreclosure began. If proceeds from the sale were enough to pay debt, interest, and costs, the mortgagor has three months to redeem his property. If proceeds from the sale did not cover debt, interest, and costs, the mortgagor has one year for redemption.

When the proceeds of the sale are not adequate, sometimes a "deficiency judgment" is levied against a debtor. This is a judgment against the debtor personally for the balance owed. California law limits this. If the seller allowed credit and has a promissory note from the mortgagor, or if someone else loaned money to the mortgagor, this is a "purchase-money" situation and cannot be collected as a deficiency judgment.

When the mortgage debt has been satisfied (paid in full) the mortgagee discharges the debt and has that fact recorded. He delivers the original note and mortgage to the mortgagor, if the mortgagor requests it in writing.

### (I) Variety of Mortgages

A variety of mortgages are available: fixed-rate mortgages, adjustable-rate mortgages, balloon-payment mortgages, graduated-payment mortgages, and equity-participation plans.

**(A) Fixed-rate mortgages** - Fixed-rate mortgages have a rate of interest that remains constant for the entire term of the loan. If it was 11 1/2% when the loan originated, it was the same when the loan terminated.

**(B) Adjustable-rate mortgages** - "Adjustable-rate mortgages" or "variable-rate mortgages" originate at one rate of interest, but are adjusted according to changes in economic conditions. If interest rates on loans in general go up, adjustable-rate mortgages will charge higher interest. If interest rates drop, these mortgages will charge less interest. Usually the rate is tied to some particular eco-

rized by any statutes. However, recent federal regulations allowing savings and loan associations to become savings banks have changed all this. By mid-1983, twenty-two California financial institutions had either converted to savings banks or were beginning conversion.

These banks do not issue stock. They are owned mutually by their depositors, who share in any profits the bank makes. Traditionally very active in the mortgage market, they invest in local residential property. They were originally created as savings institutions to help depositors practice thrift.

#### **(IV) Life Insurance Companies**

Despite the fact that life insurance companies (LICs) buy mortgages originated by others, they are considered a primary mortgage market because they also originate their own mortgages. Until the 1930s and the Depression, LICs were primarily involved in farm mortgages. LICs in the Northeast bought mortgages from other companies and developed a mutually beneficial business relationship referred to as the "correspondent system." In this system, local financial experts originate loans that they consider financially sound. An LIC then finances the mortgage. This means LICs don't have to hire local experts; they can rely on ones already at work. In return, the LICs guarantee a certain amount of money will be available to purchase mortgages, so there is a ready market for loans. A "servicing contract" covers these transactions.

Sometimes a mortgage company is limited to a correspondent relationship with only one investor; sometimes it is allowed more than one. Size is the determining factor.

LICs are governed by the laws of the state in which they originated and the laws of any state where they have offices.

#### **(V) Credit Unions**

Credit union members generally find higher interest rates on savings and may find lower interest rates on loans. Those credit unions regulated by the state have been lending mortgage money for years. Recent legislation allows federally regulated credit unions to do so, too.

#### **(VI) Retirement and Pension Funds**

Since the primary reason for retirement and pension funds is to provide financial security, they have not been greatly involved in high-risk investments. However, mortgage-

backed securities offered by GNMA (Ginnie Mae) provide a high-yield investment that is still considered secure enough to meet the demands of the Employee Retirement Income Security Act of 1974. That Act requires that trustees of pension funds use care in selecting investments and that they diversify in order to avoid substantial losses.

#### **(VII) Mortgage Brokers**

Mortgage loan brokers are licensed to bring together lenders and borrowers. They process initial applications which are then submitted for final approval to lenders.

Many mortgage brokers work for mortgage companies or are real estate brokers offering additional financial services.

#### **(VIII) Mortgage Companies**

Mortgage companies are not banks, since no one deposits money with them for safe-keeping. They originate loans by ~~borrowing the money on their line of credit with commercial banks or by selling "commercial paper," which is a short-term debt instrument, good for perhaps 180 or 270 days.~~ #86

The chief purpose of mortgage companies is to bring together borrowers and lenders from all over the country. In this way they held the flow of mortgage money from "capital-rich" sections such as the Northeast to "capital-deficit" sections such as the South and West. Most mortgage companies are located in "capital-deficit" areas.

Organized as stock companies, mortgage companies often have fewer restrictions on their lending activities than do commercial banks or savings and loans.

They sell certain types of mortgages to certain types of investors. Income-property mortgages generally go to commercial banks or to life insurance companies; residential loans, to mutual savings banks, Fannie Mae, or Ginnie Mae; all types of loans, to savings and loan associations and pension funds.

### **SECONDARY MORTGAGE MARKETS**

Secondary mortgage markets buy mortgages from primary mortgage markets. This means the primary markets have money available again to lend in new mortgages.

Many of these secondary lenders are from different parts of the country, where money happens to be more available for

# 7

## APPRAISAL

### INTRODUCTION

In the marketplace, any marketplace, things of value are exchanged for other things of value. We use money to represent the value of a thing (a good or service), to facilitate the transaction. At the heart of the transaction is always an estimation, on the part of both buyer and seller, of value. It is vitally important, if you are to compete effectively in the marketplace, that you learn how to assess value. In particular, if you are a real estate professional, you must learn something about property valuation.

#1 Brokers and salespersons should have a good understanding of: (a) the theoretical concepts of value, (b) the forces which influence value, and (c) the methods by which such value may be estimated most accurately.

Probably the question most frequently asked brokers by clients is, "How much do you think the property is worth?" It is a daily occurrence for the real estate broker to have clients ask about the fair price, fair rental, fair basis for trade, or a proper insurance coverage for the property. A broker needs to know how to answer such questions correctly.

To be successful in business, an agent must determine whether time can profitably be spent in trying to sell a property at a listing price set by the owner. The agent must keep in mind that in accepting a listing the agent is obligated to put forth best efforts to find a buyer for the property at that price. A seller's unrealistic asking price is a roadblock that can be remedied by a knowledgeable salesperson capable of making a market analysis and using the three approaches to value. Such ability assists the seller to set the most appropriate listing price.

The real estate professional is cautioned, however, not to claim greater appraisal ability or expertise than is actually possessed. Great harm can come to the client and to the professional if significant appraisal mistakes are made. When unable to competently perform an appraisal request, the advice of a professional real estate appraiser should be

sought.

### THEORY OF VALUE

#### Definition of Appraisal

To appraise means to arrive at an unbiased estimate or opinion of the value of a property. It may be said that value is the present worth of all rights to future benefits, arising out of property ownership, to typical users or investors. An appraisal report is usually a written statement of the appraiser's opinion of value of an adequately described parcel of property as of a specified date. It is a conclusion which results from the research and analysis of factual and relevant data.

Let's break down the above definition into its most important elements:

1. Appraisal is unbiased.
2. Appraisal is an opinion or estimate.
3. Value is present worth of all rights to future benefits arising out of property ownership to typical users or investors.
4. An appraisal report is a written statement of an appraiser's opinion of value of an adequately described parcel of property as of a specified date resulting from research and analysis of factual & relevant data.

Real estate appraisal methods are being standardized by virtue of the experience and practice of qualified people in all parts of the country who encounter the same types of valuation problems, and who by various methods and processes succeed in solving them in an equitable manner. It is natural, however, that differences of opinion may exist as to the value of specific parcels of real estate and the means of estimating their value.

5. *Principle of Highest and Best Use.* The best use a parcel of land (known as its highest, best, and most profitable use) is that which will most likely produce the greatest return to the land over a given period of time. This net return is realized in terms of money or other amenities.

The application of this principle is flexible. It reflects the appraiser's opinion of the best use for a property as of the date of his appraisal. At one period of time, the highest and best use of a parcel of land in a downtown business district might be for the development of an office building, at another time a parking lot.

A single-family house on a commercial lot may not be the highest and best use for the site. A four-unit apartment building on multiple-zoned land suitable for 30 units is probably not the long-term highest and best use of the land.

It is also useful to understand highest and best use may no longer be only economic or profit making in character. Environmental, aesthetic, and historical considerations are increasingly important in governmental views of highest and best use.

The American Institute of Real Estate Appraisers at Page 244 of the 8th Edition of "The Appraisal of Real Estate" offers these two definitions for highest and best use:

"The reasonable and probable use that supports the highest present value, as defined, as of the date of the appraisal."

And...

"The use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and that results in the highest present land value."

The first definition applies to land with improvements; the second, to vacant land or land to be made vacant.

Determining highest and best use includes assessing buyers' motives, the existing use of the property, potential benefits of ownership, the market's behavior, community or environmental factors, and special conditions or situations which come to bear on appraisal conclusions of value.

#17  
6. *Principle of Progression.* The worth of a lesser valued object tends to be enhanced by association with many similar objects of greater value.

7. *Principle of Regression.* The worth of a greater valued object tends to be reduced by association with many lesser valued objects of the same type.

8. *Principle of Contribution.* A component part of a property is valued in proportion to its contribution to the value of the whole property or by how much that part's absence detracts from the value of the whole. Maximum values are achieved when the improvements on a site produce the highest (net) return, commensurate with the investment.

9. *Principle of Anticipation.* Value is created by anticipated future benefits to be derived from the property. In the Fair Market Value Analysis appraisers estimate the present worth of future benefits. This is the basis for the income approach to value. Simply stated, the income approach is the analysis of the present worth of (1) projected future net income, and (2) future resale value anticipation. Historical data are relevant as they aid in the interpretation of future benefits.

10. *Principle of Competition.* Competition is created where substantial profits are being made. If there is a profitable demand for residential construction, competition among builders will become very apparent. This could lead to an increase in supply in relation to the demand, resulting in lower selling prices and unprofitable competition, leading to renewed decline in supply.

11. *Principle of Balance.* Value is created and sustained when contrasting, opposing, or interacting elements are in equilibrium, or balance. Proper mix of varying land uses creates value. Imbalance is created by an over improvement or an under improvement. Balance is created by developing the site to its highest and best use.

12. *Principle of Three Stage Life Cycle.* In due course all material things go through the process of wearing or wasting away and eventually disintegrating. All property is characterized by three distinct stages described as development, maturity, and old age (or growth, stability, and decline).

Single properties, districts, neighborhoods, etc., tend generally to follow this pattern of growth and decline. It is also evident this process can be reversed as neighborhoods and individual properties in older residential areas are renewed and restored.

Revitalization and modernization in inner-city older neighborhoods may result from organized government programs or as a result of changing preferences of individual buyers. Most neighborhoods remain in the mature or stable stage for many years with decline being hardly noticeable.



## FAIR MARKET VALUE

In appraisal practice, the term Fair Market Value, or simply "market value" may be defined as:

"The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress."

Fundamental assumptions and conditions presumed in this definition are:

1. Buyer and seller are motivated by self-interest.
2. Buyer and seller are well informed and are acting prudently.
3. The property is exposed for a reasonable time on the open market.
4. Payment is made in cash, its equivalent, or in specified financing terms.
5. Specified financing, if any, may be the financing actually in place or on terms generally available for the property type in its locale on the effective appraisal date.
6. The effect, if any, on the amount of market value of a typical financing, services, or fees shall be clearly and precisely revealed in the appraisal report.

This information is drawn from "The Appraisal of Real Estate," The American Institute of Real Estate Appraisers, 8th Edition, Page 33.

The legal definition of Fair Market Value under California eminent domain law, found in the Code of Civil Procedure, Section 1263.320, states, "The fair market value of the property is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with the full knowledge of all the uses and purposes for which the property is reasonably adaptable and available."

## VALUE, COST AND PRICE

Value has to do with the combined factors of present and future anticipated enjoyment, or profit. Cost represents a measure of past (or prospective) expenditures in money,

labor, material, or sacrifice of some nature in acquiring or producing the commodity in question. Price is what one pays for a commodity, regardless of pressure, motives or intelligence of the seller or buyer.

## THE FOUR ELEMENTS OF VALUE

There are only four elements of value, all of which are essential. These are:

1. utility
2. scarcity
3. effective demand
4. transferability

None of these alone will create value. Something may be scarce, but have no utility. Air has great utility, but since it is not particularly scarce, it has no great demand. Generally speaking, a commodity will have commercial or marketable value in proportion to its utility and relative scarcity. Scarcity is the present or anticipated supply of a product in relation to the demand for it. Utility creates demand, but demand, to be effective, must be implemented by purchasing power.

## PROPERTY VALUE FACTORS

Generally speaking, the value of real estate will be greatly affected by (1) environmental and physical characteristics, (2) social ideals and standards, (3) economic influences, and (4) political and government regulations. These things interact to create a constant state of change in property values. Among more specific factors which determine the value of property, the following are very important:

1. *Directional Growth.* Cities tend to grow in particular ways, as we discuss in another chapter, and valuation must take into account a city's growth patterns, as well as any urban renewal plans and city zoning ordinances affecting growth.
2. *Location.* This is an extremely important value factor in real estate because location influences the demand for the property. Location must not be described too generally, and is an effective value factor only when it is specifically related to highest and best use. Brokers often claim, "The three most important characteristics for any property are location, location, location."
3. *Utility.* Utility includes the capacity to produce. This important factor involves judgment as to the best use to

which a given property may be put. Building restrictions and zoning ordinances affect utility.

4. *Size.* The width and depth of a parcel of land will often determine the possibilities and character of its use.

5. *Corner Influence.* Corner sites sometimes have higher unit value than a site fronting on one street only. Disadvantages include loss of privacy, cost is higher as off-site improvements cost more and lot maintenance is more expensive, and setbacks may require a smaller size house. Commercial properties benefit from corner sites because of easy access and added exposure.

6. *Shape.* Parcels of land of irregular shape generally cannot be developed as advantageously as rectangular lots.

*Thoroughfare Conditions.* The width of streets, traffic congestion, condition of pavement have an effect on the value of those properties fronting on a given street and to a lesser degree other properties in the neighborhood.

8. *Exposure.* The south and west sides of business streets are usually preferred by merchants because the pedestrian traffic seeks the shady side of the street in warm afternoon weather, and merchandise displayed in the windows is not damaged by the sun. This traditional view of older commercial districts is somewhat offset by (1) new architectural concepts such as shopping malls and (2) parking and convenience.

9. *Character of Business Climate.* The larger cities develop multiple residential, commercial shopping areas, offices, medical suites, as well as financial, wholesale, industrial and commission-house districts.

10. *Plottage or Assemblage.* An added increment of value of several parcels of land under one ownership as opposed to the same number of parcels under separate ownership. In highly urbanized multiple residential and commercial areas plottage, or assemblage, makes it possible to gain a higher utility than could be found for the parcels considered separately. This principle may also be applied to light industrial areas.

11. *Topography and Character of Soil.* The bearing qualities of the soil may affect construction costs. Extensive foundations are usually necessary in soft earth. The type and condition of the topsoil affect the growth of grass, plants, shrubs and trees. Value may also be influenced by land contour and grades, drainage and view points.

12. *Obsolescence.* Caused by external or economic

changes and decreasing functional utility of a property or deterioration. Changes in types and methods of construction, style of architecture, interior arrangements for specific purposes, all may render a particular building out of date.

13. *Building Restrictions and Zones.* These sometimes operate to depress values and at other times to increase them.

## ECONOMIC TRENDS AFFECTING REAL ESTATE VALUES

Property values increase, decrease, or remain stable, based on the interaction of the four forces influencing value mentioned above (environmental/physical characteristics, social ideals and standards, economic influences, and political or governmental regulations). Economic trends and forces at higher levels — regional, national, and international — affect property values at a local level. The real estate appraiser must recognize that the general pattern of statistical analysis that guides his interpretation of value influences on a national level should be used in the general analysis of state and regional forces which in turn influence local property values.

The appraiser should, therefore, follow national and regional economic trends, changes in national income levels, international developments, and government financing policies, because the greater the severity and duration of any economic swing, the wider and deeper is its influence.

Conditions to be observed include:

1. gross national product
2. balance of payments to other countries
3. national income levels
4. employment
5. price level indexes
6. interest rates
7. fiscal and monetary policies
8. building starts
9. credit availability

In short, appraisers are subject to the same economic influences as the rest of us, and must keep their finger on the pulse of the economy just as carefully as anyone else, if not more so.

It should be noted that there is no real difference between

vacancy and the costs of operating the building (not including mortgage payments) to arrive at the annual net income for that property. Then he multiplies that by the "capitalization rate" to get the value.

rental data for at least four properties that have been recently sold. Each property is analyzed separately, and a reasonable GRM is determined from those results. The GRM always uses monthly income. Its formula is

$$\text{Rental Income} \times \text{GRM} = \text{Estimated Market Value}$$

#100 The "capitalization rate" is based on the rate of return an investor expects, which usually means the rate of interest earned on the investment. It can be determined by dividing the selling price of similar properties by their net income.

## RECONCILING APPRAISAL FIGURES

Formulas for determining the capitalization rate are:

$$\text{Income} = \text{Value} \times \text{Rate} \quad \text{Value} \times \text{Rate} = \text{Income Rate}$$

$$\text{Income} = \text{Rate Value}$$

The capitalization rate always uses annual net income.

After the value of a property has been established by the three approaches—market data, cost, and income—the estimated selling price needs to be established.

It is not an average of the three answers. The three methods are used to check each other. One of the three is more appropriate for the type of property than the other two are. That amount, varied slightly according to the other two, is the best estimate of sale price.

**(B) Gross Rent Multiplier** - Some property, such as single-family homes, is not usually purchased for the income it produces. In this case the Gross Rent Multiplier (GRM) can be used to appraise it. Using the GRM requires

## WRITTEN ASSIGNMENT 7 Chapter 7

- In an appraisal report, the value conclusion can be made for:
  - any date in the past, but no date in the future
  - any date in the future, but no date in the past
  - any date at all
  - none of the above
- Which is true of appraisal?
  - it is unbiased
  - it is an opinion or estimate
  - both "A" and "B"
  - neither "A" nor "B"
- Which principle holds that maximum value is realized when land uses are compatible and a reasonable degree of architectural harmony is present?
  - principle of change
  - principle of conformity
  - principle of substitution
  - none of the above
- Which would be included under a "bundle of rights"?
  - right to occupy and use
  - right to sell in whole or in part
  - both "A" and "B"
  - neither "A" nor "B"
- Property rights are limited by which of the following?
  - the government's power of taxation
  - the government's power of eminent domain
  - police power
  - all of the above
- Depending upon the appraisal assignment, the following approaches to property valuation, may be used: sales comparison approach, cost approach, and income capitalization approach.
  - false
  - true
- In relation to the process of appraisal, brokers and salespersons should have a good understanding of:
  - the theoretical concepts of value
  - the methods by which value may be estimated most accurately
  - both "A" and "B"
  - neither "A" nor "B"
- An appraisal report is a written statement of an appraiser's opinion of value of an adequately described parcel of property:
  - as of a specified date
  - resulting from research and analysis of factual and relevant data
  - both "A" and "B"
  - neither "A" nor "B"
- Which principle says that value will tend to be set by the cost of acquiring an equally desirable substitute?
  - principle of conformity
  - principle of substitution
  - principle of supply and demand
  - none of the above
- Which principle says that the worth of a lesser valued object tends to be enhanced by association with many similar objects of greater value?
  - principle of progression
  - principle of regression
  - principle of contribution
  - none of the above

# 8

## TITLES AND INSURANCE

### HISTORY OF LAND OWNERSHIP IN CALIFORNIA

# 18  
It is appropriate to begin a discussion of property titles and insurance in California and applicable laws with a brief historical overview of land titles in this state. The story of California is one of the most picturesque among the histories of our states. From the time in 1513 when Vasco Nunez de Balboa first sighted the Pacific Ocean, claiming it and the shores washed by it for the King of Spain, until 1822, the lands that are now California were part of the Spanish realm.

During this period of Spanish rule, the local government was of a patriarchal nature, with little regard for formal civil law. Military law prevailed as presidios or army garrison towns were established to maintain Spanish dominion over the vast and varied, but sparsely populated territory. As instruments for spreading the Christian faith, and for the more mundane purpose of providing supplies for the military posts, numerous missions were established, beginning in 1769 with the Franciscan mission at San Diego.

All land in California was held in the name of the King of Spain, and technically it belonged to him. Ownership and transfer of land and property rights therein were governed by the law prevailing in Spain. Significantly, Spain, like the other leading countries on the Continent of Europe, used the Roman Civil Law as distinguished from the Common Law followed in England and its colonies.

In Civil Law countries the judges were guided by elaborate and detailed codes imposed by the sovereign. Under the Common Law of England, on the other hand, the judges, in hearing and deciding cases, recognized and enforced the customs and usages of the people. To be sure, when specific legislation on a question had been enacted, the judges would accept and apply it. And so it was that at the time of the American Revolution the Common Law of England then in force (including applicable acts of Parliament) became a part of our law. Since then it has continued

to develop in this country with contributions by both legislative bodies and the courts.

Returning now to California under the Civil Law of Spanish rule: the use of the land could be acquired only by political or military agencies of the king. These rights to the use of the land were not, however, grants of an absolute fee title. Thus it was that several rancho grants made by the Spanish monarchs were solely for limited grazing and agricultural purposes.

**Mexican Rule.** In 1822 Mexico, then a territorial possession of Spain, established its independence. Inspired by the stories of fabulous wealth in California, the Mexican government encouraged colonization. Governors were given absolute discretion in the selection of the persons who could receive grants of land. An applicant for land filed a petition with the governor and, if approved received a decree which was referred to the legislative body for ratification.

Upon such approval a formal grant of the land petitioned for was made. This grant, together with the various instruments appurtenant thereto, was filed and recorded in the government archives and was known as "expediente."

Other steps in the transfer of property from the state to the individual was the marking off of monuments on the land being transferred, and establishing the grantee in possession. The latter act was usually done by some officer with judicial capacity. The governor was empowered to recognize grants and possessory rights formerly made by the Spanish government.

**American Rule.** In the early 1800s it became increasingly apparent, by reason of the immigration of American settlers to the Pacific coast, that Mexico could not maintain its sovereignty over California. Conditions in California became chaotic, and after years of turmoil and disorder the Bear Flag Republic emerged, to be followed by the American conquest of California during the Mexican War. Commo-

resulting records over the years become a complicated history in themselves, yet they may be woefully incomplete for purposes of determining the status of the title in question. This is so for a variety of reasons.

For example: In an intestate transfer upon death, a qualified heir might have inadvertently been excluded; or a transfer, valid on its face, may have been made by a person incompetent because of age or mental condition. Then too, other official records may profoundly affect the picture (e.g., tax records and records of court judgments). In short, ownership of land and marketability of title depend not only on recorded facts of title transfer, but also upon a vast array of extraneous information.

#92 ✓  
**Abstract of Title.** As might be expected under such complex circumstances, historically the individual buyer or lender was ill-equipped to make the necessary investigation of the status of the title to property. They soon came to rely on the title specialist who made a business of studying the records, and preparing summaries or abstracts of title of all pertinent documents discovered in the search. The abstract of title together with a lawyer's opinion of the documents appearing in the abstractor's "chain of title" were the basis of our earliest attempts to establish merchantable title. This method still exists today, with modern refinements.

**Certificate of Title.** In time abstracters accumulated extensive files of abstracts and other useful data, including "lot books" wherein references to all recorded documents were systematically arranged according to the particular property affected, and "general indices" wherein landowners were listed alphabetically together with information concerning them and affecting titles (e.g., probates, property settlements, etc.).

These files came to be known as "title plants" and provided classified and summarized histories of real estate transactions and of other activities which affect or might affect ownership of the land in the areas covered. With the growth and improvement of title plants and increased proficiency of examiners employed by the abstracters (or by abstract companies, for often they were incorporated), the formal abstract of title for delivery to the customer and the related legal opinion were sometimes dispensed with completely. The abstract company would simply study its records and furnish the customer with a certificate of title in which it stated that it found the title properly vested in the present owner, subject to noted encumbrances. The certificate plan has strictly limited use today, for it was a transitional method of assuring titles.

**Guarantee of Title.** The next step was the guarantee of title under which the abstract company did more than certify the

correctness of its research and examination. As the name suggests it guaranteed the title to the owner.

Thus the company agreed to indemnify the customer against loss if the title proved to be otherwise than as described. This meant it was engaged in the insurance business and generally was subjected to regulation as such.

**Title Insurance.** All three plans previously outlined -- abstract-opinion, certificate of title, guarantee of title -- are based upon examination of public records, and any protection they afford is limited to matters disclosed by an examination of the public records. True, much vital information is obtained from such records. The files of the county recorder's office and such other sources as the county clerk, various tax agencies, federal court clerk, and the Secretary of State all are important sources of data bearing upon land titles.

However, as already noted, the public records may be incomplete or erroneous, and they do not necessarily disclose shortcomings arising from forgery, incompetence, and failures to comply with legal requirements. Accordingly the policy of title insurance was developed as the culmination of the quest for marketability of title. Although still covering most risks which are a matter of public record, it alone extends protection against many nonrecorded types of risks, depending on the type of policy purchased. The title insurance company continues to utilize the title plant and with competent examiners and legal assistance it conducts as accurate a search of the records as feasible, and seeks to interpret correctly what it finds in the records. But its unique contribution is the protection it affords against risks which lie outside the public records.

**Standard Policy.** The standard policy of title insurance, in addition to risks of record, protects against:

Off-record hazards such as forgery (e.g., a forged deed in the chain of record title), impersonation, and lack of capacity of a party to any transaction involving title to the land (e.g., a deed of an incompetent or an agent whose authority has terminated, or of a corporation whose charter has expired); the possibility that a deed of record was not in fact delivered with intent to convey title; the loss which might arise from the lien of federal estate taxes, which is effective without notice upon death; and the expense, including attorneys' fees, incurred in defending the title -- whether the plaintiff prevails or not.

The standard policy of title insurance does not, however, protect the policyholder against defects in the title known to the holder to exist at the date of the policy and not previously disclosed to the insurance company; nor against easements and liens which are not shown by the public

records; nor against rights or claims of persons in physical possession of the land, yet which are not shown by public records (since the insurer normally does not inspect the property); nor against rights or claims not shown by public records, yet which could be ascertained by physical inspection of the land, or by appropriate inquiry of persons on the land, or by a correct survey; nor against mining claims, reservations in patents, or water rights; nor against zoning ordinances.

These limitations are not as dangerous as they might appear to be. To a considerable extent they can be eliminated by careful inspection of the land involved and routine inquiry as to the status of persons in possession. However, if desired, most of these risks can be covered by special endorsement or use of extended coverage policies at added premium cost.

**A.L.T.A. Policy.** In California many loans secured by realty have been made by out-of-state insurance companies which were not in a position to make personal inspection of the properties involved except at disproportionate expense. For them and other nonresident lenders, the special A.L.T.A. (American Land Title Association) policy was developed. It expands the risks normally insured against under the standard policy to include the following:

1. Unrecorded liens
2. Off-record easements
3. Rights of parties in physical possession, including tenants and buyers under unrecorded instruments.
4. rights and claims which a correct survey or physical inspection of the land would show.
5. mining claims, reservations in patents, and water rights.

Needless to say, the insurance company issues such a policy only after itself obtaining a competent survey and physical inspection of the property.

**Extended Coverage.** The American Land Title Association has adopted an owner's extended coverage policy (designated as A.L.T.A. Owner's Policy Form, Standard Form, as amended 1970) that provides to buyers or owners the same protection that the A.L.T.A. policy gives lenders. But note that even in these policies no protection is afforded against defects on other matters concerning the title which are known to the insured to exist at the date of the policy yet have not previously been communicated in writing to the insurer, nor against governmental regulations concerning occupancy and use. The former limitation is self-explanatory; the latter is due to the fluid and frequently changing nature of governmental zoning regulations.

**Title Insurance Companies in California.** Under the provisions of the Insurance Code of California, each title insurance company organized under the laws of this State must have at least \$500,000 paid-in capital, and must deposit with the Insurance Commissioner a "guaranteed fund" of \$100,000 in cash or approved securities.

It must also set apart annually, as a title insurance surplus fund, a sum equal to 10 percent of its premiums collected during the year, until this fund equals the lesser of 25 percent of the paid-in capital of the company or \$1,000,000. This fund -- very substantial in the case of the larger and older companies -- is constantly maintained as a further security to the holders and beneficiaries of policies of title insurance.

Policies of title insurance are now almost universally used in California, largely in the standardized forms prepared by the California Land Title Association, which is the trade organization of the title companies of the state. Every title insurer must adopt and make available to the public a schedule of fees and charges for title policies. today it is the general practice in California for buyers, sellers and lenders -- as well as the attorneys and real estate brokers who serve them -- to rely on title insurance companies for title information, title reports and policies of title insurance.

**Rebate Law.** Title companies are required to charge for title reports under the terms of legislation adopted at the 1967 general session of the California Legislature. The rebate law requires the title companies to not only charge for reports, but to also make sincere efforts to collect them except in certain defined circumstances.

Title insurance companies can still furnish "the name of the owner of record and the record description of any parcel of real property" without charge.

The statute extends the anti-commission provisions of Section 12404 of the Insurance Code to prohibit direct or indirect payments by a title company to principals in a transaction as a consideration for title business.

Thus, the law prohibits a title company from paying, either directly or indirectly, any commission, rebate, or other consideration as an inducement for or as compensation on any title insurance business, escrow or other title business in connection with which a title policy is issued.

**Torrens System of Land Registration.** Of purely historical interest in California -- although still found elsewhere -- is the Torrens system of land title registration, patterned after the system of registering titles to ships. It was adopted here in 1914 as the Land Title Act, and provided for registration after a court decree in an action similar to a quiet title suit.

# 9

## ESCROW

### INTRODUCTION

Most real estate sales in California close in escrow, so it is important that a broker know what an escrow is, what closing involves, and what he needs to do to help sales close.

This chapter discusses the purpose of escrow, the duties of an escrow agent, closing an escrow (and thereby completing a sale), and the effects of the Federal Real Estate Settlement Procedures Act (RESPA).

### ESCROW

According to Section 17003 of the California Financial Code, "escrow means any transaction wherein one person, for the purpose of effecting the sale, transfer, encumbering or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by such third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by such third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter."

#3 What that means is that documents and advance money related to both the sale of real estate and the loans to pay for it are deposited with a neutral third party — someone who won't benefit directly from the sale. An "escrow agent" is the neutral third party in charge of the escrow. After everything has been completed, signed, and recorded, the escrow agent sees that each party gets the consideration to which he agreed. Put simply, the escrow agent sees that seller gets his money and buyer gets his deed and mortgage papers.

### ESCROW AGENT'S DUTIES

#5 The escrow agent takes care of anything and everything needed to complete sale and loan in order to close the

transaction. He is responsible for many transactions and must gather a number of documents.

#### (I) Documents

In a real estate sale involving a house, for example, he must gather all paperwork related to the sale, and all paperwork related to the loan the buyer needs, if the sale is to go through.

On the seller's side, he needs, among other things, a deed for the property; title insurance or other proof of title; information on current mortgages, loans, and liens, including demand or beneficiary statements showing the exact amounts needed to pay them off; current fire and hazard insurance policies; and the seller's instructions.

On the buyer's side, among other things, the escrow agent needs mortgage papers, including promissory note, other necessary documents relating to purchase of the property, the rest of the cash promised by buyer, and buyer's instructions.

Other reports that may be needed are appraisal, survey, tax report, and reports on soil, mineral rights (if any), geologic hazards, termites and other pests, etc. If the property is new, being built, or about to be built, he also needs a contractor's report to be sure there are no mechanic's liens on the property, as they would have first claim to the money.

Escrow information is confidential in nature. Only those people directly concerned with a document or other information see it; it is not revealed to others.

When all the documentation is complete, the escrow agent sees that all forms are recorded in proper legal order, usually by sending them to a title insurance company, where they make a final check before recording. They are careful to see that seller's release of the deed is recorded before buyer's mortgage loan, as he cannot borrow on something to which he does not legally have title. The escrow agent's files need to be completely up-to-date at all times and he should keep a calendar of when things are due back to him.

## (II) Finances

The escrow agent "prorates" property taxes and other financial matters related to the property. That means he divides the cost fairly between buyer and seller. Besides property taxes, he might prorate rents, operating expenses for income property, security deposits, maintenance and security costs, interest on a mortgage, the lender's impound account, and fire insurance premiums.

"Impounds" are amounts of money put aside (reserved) for paying taxes and insurance. Sometimes the amount is added to monthly loan payments.

Closing costs include "points", which may also be called "origination fee", "commitment fee", "loan fee", or "service charge". By any name, these cover the cost of appraising the property, running a credit check on the buyer, preparing paperwork for the buyer's loan, and other necessary expenses.

After all financial transactions are finished, the escrow agent prepares a "closing statement" (also called a "settlement statement") for each party. This statement shows all his transactions on behalf of the two parties. When all the instructions have been carried out, escrow can close.

## VALID ESCROW

A valid sales escrow requires that buyer and seller have entered into a binding contract and that the escrow agent has a written agreement with them, containing instructions about transferring title to the property.

Sometimes instructions in the escrow agreement conflict with those in the original contract. If that happens, the escrow agent usually follows the instructions in his agreement, as that contract was made later than the other one.

Escrow instructions can be bilateral or unilateral. Bilateral instructions are given jointly by both parties, while unilateral instructions are given separately by each party.

## ESCROW RULES AND PRINCIPLES

Once the escrow agreement has been signed by both parties, it can no longer be changed by just one of them. Both must agree in writing to any change. However, one person may waive a condition in the agreement as long as that does not work against the other party.

If the two parties have any disagreements about the contract, the broker should try to help them work things out. The escrow agent does not solve their conflicts and should offer no advice. His job is to see that all paperwork is completed and the transaction closed. He has no power to act as mediator. He is a "stakeholder", the person who holds the stakes (in this case, documents and money) while the two sides fight it out. The escrow agent can also be an "interpleader", a person who steps back from a conflict and asks the courts to require the principals to settle it among themselves.

The escrow instructions he works from should be brief, written, clearly worded, definite, and agreed to by both sides. Only those areas and documents included in the instructions are handled by the escrow agent.

## IN ESCROW

Buyer and seller retain certain interests while in escrow.

### (I) Seller's Interest

As they enter escrow, seller still has legal title to the property. His interest is transferable, but as long as he still has it, he can mortgage it. When he dies, his heirs inherit his interest — which includes any unpaid portion of the purchase price.

### (II) Buyer's Interest

Once the deposit receipt is signed, the buyer has "equitable" interest in the property. Equitable interest can also be left to heirs and a mortgage can be arranged, conditional to closing escrow. When all escrow instructions have been followed, and seller has paid what he promised, he receives a deed transferring title to him.

If by some unlucky chance the seller dies or goes insane or declares bankruptcy before the buyer receives title, he may find it difficult and expensive to get a clear title to the property.

**CLOSING**

#54

Closing a real estate transaction has three forms: closing the sale, legal closing, and financial closing.

### (I) Closing the Sale

Closing the sale happens when buyer and seller have come to a mutual agreement and signed the deposit receipt that



serves as a sales contract. At this point, their transactions go into escrow to finish closing.

### **(II) Legal Closing**

Legal closing happens when all paperwork for transferring title has been completed and recorded in the proper order. All the paperwork for financing the purchase has also been completed.

### **(III) Financial Closing**

Money is actually paid over and a written accounting (settlement statement) is given to each party, in order to close financially.

Legal and financial closing are normally handled in escrow; money and title are then transferred at the same time.

## **TERMINATION OF ESCROW**

Escrow can terminate in two ways: it can close or it can be canceled.

### **(I) Closing Escrow**

As soon as all conditions in the instructions have been met, escrow can be closed. The escrow agent then sees that everything is recorded and distributed to the proper persons. At that point the sales contract (deposit receipt) can be executed and escrow can be terminated.

Usually, with an escrow closing, it is not necessary for all principals to be present when it closes, since the neutral third party (escrow agent) will see that each gets his proper share.

### **(II) Canceling Escrow**

If a specific time limit has been set and some of the escrow instructions are not finished at that time, the parties may cancel escrow and each receive their original possessions.

The escrow holder should not have to decide whether someone did not perform his share of the contract. Everything should be spelled out in the escrow instructions.

Cancellation of escrow does not automatically mean that the purchase is canceled, too. That needs to be written into the agreement.

## **LICENSING ESCROW AGENTS**

Escrow departments can be found in title companies, savings and loans, and banks; as independent businesses; and as part of a number of real estate businesses. #8/

With certain exceptions, escrow agents are licensed by the state. The exceptions are limited, and are granted to real estate brokers, attorneys, title insurance companies, banks, and savings and loans. These are subject to regulation within their own fields.

### **(I) Brokers as Escrow Agents - Restrictions**

Real estate brokers involved in escrow cannot advertise that as part of their company name. If escrow services are advertised at all, the broker must make it clear they are part of his real estate business only.

Only the broker is exempted from having an escrow license. He cannot form an escrow association with other brokers and he cannot delegate escrow duties to anyone else. He must be either the listing or the selling broker in a real estate sales transaction for which he is providing escrow service, unless he is one of the parties involved. He must keep careful records and place all escrow money he receives into a trust fund.

### **(II) Licensed Escrow Agents - Restrictions**

No individual can be a licensed escrow agent. Licensed escrow agents must be employed by a licensed escrow corporation and each must post a \$10,000 bond. Escrow agency employees in any capacity must post indemnification bonds as protection against loss of the money and valuable documents (securities) they will be handling. Money held in escrow does not belong to the escrow agent and cannot be taken by the law to pay the agent's personal debts. Escrow agents are audited annually, at their own expense, by independent auditors.

Escrow agents are not allowed to pay referral fees to brokers, nor can brokers suggest an escrow holder unless asked by the principal.

## **RESPA**

The Federal Real Estate Settlement Procedures Act, better known as RESPA, became law of June 30, 1976. It requires that closing costs on mortgage loans, if they are from federal agencies or from financial institutions whose deposits are federally insured, be reported on special forms, following certain procedures.

# 10

## LEASEHOLD RELATIONSHIPS

### INTRODUCTION

#20  
A lease is a contract that allows one person exclusive use of property belonging to someone else. The one who owns the property is the landlord, also known as the "lessor." The one who uses the property is the tenant, also known as the "lessee". The contract has to be in written form only if it is to last for more than one year. If it is not written, it is assumed to last for the length of time for which a person has paid. That is, if he pays weekly, he has a weekly lease; if he pays monthly, he has a monthly lease.

This chapter will discuss various types of leases and leasehold estates, certain provisions of leases, and means of terminating them.

### TYPES OF LEASE

The type of lease depends on how the amount of rent is determined. In a "gross lease", which is the basis for renting most apartments, the tenant pays a fixed amount of rent and the landlord pays insurance coverage for the parts of the building for which he still has control, property taxes, costs of repairs, and mortgage payments. These expenses are called "property charges".

In a "net lease", the tenant pays the property charges directly, plus an additional sum to the landlord each month. This type of lease is most often for a commercial or industrial building. In a "percentage lease," the tenant, usually a retail merchant, pays a percentage of his monthly income (either gross or net) as part of his rent, plus a minimum monthly fee. The percentage is negotiable.

A "variable lease" allows the amount of rent to increase during the leasing period. "Graduated lease" increases the rent at pre-set times; "index lease" changes the rent accord-

ing to the government's cost-of-living index.

"Ground leases" are for the land only, but the tenant is allowed to build on the land. These are normally net leases as well. They may run for 50 or more years, with a maximum of 99 years if the property is inside city or town limits.

"Oil and gas leases" are usually paid by a flat fee to the landowner. If nothing is found, the lease normally terminates in one year. Often it contains a clause permitting renewal of the lease for the payment of another flat fee. If oil or gas is found, the owner of the property usually receives a royalty of one-eighth of the value, and the lease then continues as long as significant quantities of oil or gas continue to be found.

### LEASEHOLD ESTATES #13

Leasehold estates come in four basic types: estate for years, estate from year to year, estate at will, and estate at sufferance.

#### (I) Estate for Years

An "estate for years" has a definite termination date, at which time the tenant is expected to vacate the premises. No termination notice is required for this. The actual time the lease runs may be less than a year, as long as it is for a definite period.

#### (II) Estate from Year to Year

An "estate from year to year" could be, from month-to-month" or "week-to-week." It means that the tenant can continue to use the property as his for as long as he continues to pay the rent at fixed intervals.

#### (III) Estate at Will

An "estate at will", also known as "tenancy at will", may last for any length of time, and may be terminated by either party. The tenant continues to pay rent periodically, so it is often difficult to distinguish this from an "estate from year to year". However, an estate at will might exist if, for example, the property was being taken over by the city by right of eminent domain, but the landlord allows the tenant to stay there until the city actually takes possession of the property. If either landlord or tenant dies, an estate at will is automatically terminated.

#### (IV) Estate at Sufferance

An "estate at sufferance" or "tenancy at sufferance" exists when the tenant does not move out even though the lease has expired. Although the tenant was legally entitled to live there as long as the lease was in effect, he is now occupying the property without the landlord's permission.

## PROVISIONS OF LEASE

A lease must be between parties who are legally competent to contract and who have reached a mutual agreement about the terms of the lease. The lease must be legal, and if it is to be in effect for more than one year, it must be in writing. It is best to have any conditions in writing, regardless of the length of the lease.

The lease must be an exchange of use of the property for a valuable consideration, usually rent. The property being leased should be accurately described and the parties involved must sign the lease if it is written.

Leases commonly include certain provisions such as duration, amount of rent, possession, responsibility for maintenance and improvements, liability for injuries, assignment or subletting, security deposits, special covenants and conditions, and termination.

#### (I) Duration

The duration of a lease is the length of time it is in effect. This is generally the period of time the rent covers — a month, if the rent is paid monthly; a week, if it is paid weekly. Leases are usually renegotiated when they are renewed. If they are not renegotiated, they are usually extended with the same provisions.

# 35  
Leases that were extended after Jan. 1, 1976 may have had an automatic extension clause printed in the lease. This is legal only if the tenant (lessee) prepared the lease, the clause was printed in 8-point boldface type, and a statement about the clause appeared — also in 8-point boldface type — just

above where the lessee signs.

#### (II) Rent

Rent is the amount paid by the tenant for the use of the landlord's property. The lease should say when and how it is to be paid. If rent is to be paid at the beginning of the month (or whatever time period), this must be in the lease. This is because, under the law, rent is due only at the end of the time period.

Liens for rent can be claimed by those who provide temporary housing — such as hotels and motels — and those who provide housing units such as apartments and bungalow courts. These liens are against baggage and personal property, but they may not include prosthetic or orthopedic appliances used by the guest, tenant, or lodger.

The tenant is liable for the rent as long as the lease is in effect, even if the tenant abandons the property, unless the tenant can prove that the owner has not kept the property fit for human habitation.

#### (III) Possession

Under the terms of the lease, the tenant is entitled to possession of the property. The lessor (landlord) guarantees that the lessee (tenant) will be able to enjoy the use of the property without interference by the lessor.

The landlord does retain the right to re-enter the property under certain circumstances. He may enter if it is an emergency, if repairs or improvements are urgently needed or being made with the tenant's consent, if the tenant has abandoned the property, or if the court orders him to do so. Except for these circumstances, he is to respect the tenant's right to privacy. The circumstances are spelled out in Civil Code Section 1954 and the tenant's rights are protected under Section 1953.

#### (IV) Maintenance

The landlord must maintain certain minimum standards for the health and safety of the tenants. The property must have hot and cold running water, sewer or septic tank connections, and gas connections all in working order. Windows and doors must be unbroken and the roof must not leak. Floors must be in good condition, as must any and all stairways and their railings. Heating system, electric lights and wiring must be in good working order and safe for tenants to use. Adequate trash containers must be provided, and the property must be free of mice, rats, roaches, and other pests, as well as large piles of trash. The landlord must maintain areas that remain under his control,

A landlord trying to evict a tenant is forbidden by law to interfere with utility service to that tenant, even if the utility service is under the landlord's control.

# 96  
**(B) Constructive eviction (by tenant)** - The tenant has the right to sue if the landlord breaches the contract. If the premises become uninhabitable because of the landlord's negligence, the tenant has the right to abandon the premises in a "constructive eviction." If the tenant can prove the landlord's negligence and he has removed himself from the premises, the lease can be terminated.

## RIGHTS

Landlords and tenants each have certain rights and remedies.

### (I) Remedies for the Landlord's Benefit

The landlord may sue to collect unpaid rent. If the tenant abandons the property and the landlord sublets it, the landlord may sue the original tenant for any difference in the rent, if the sublet was for a lower amount. If the tenant is in possession of the property and refuses to give it up or pay rent, the landlord can, after serving a three-day "pay or quit" notice, file an "unlawful detainer action". This can be a complicated legal procedure and an attorney should be employed.

When the landlord shows that the rent has not been paid or the contract has been breached, the court can issue a "writ of possession" which entitles the landlord to reclaim the property. The tenant must move out. However, the landlord must post bond, because if the courts later find that the tenant should not have been evicted, the landlord will have to pay damages.

If personal property belonging to the tenant remains on the premises, the landlord is required to store it for 30 days. He

can collect storage fees from the tenant when the property is reclaimed. If the property is stored on the premises, the storage fee can be the fair amount of rent for the property. If the tenant does not collect his property within 30 days, it may be sold at public sale. The landlord collects storage fees and costs of the sale from the proceeds of the sale. Any money left over belongs to the tenant.

### (II) Tenants' Rights

Tenants' rights are protected under Sections 1950.5 and 1954 of the Civil Code. In addition, the tenant has the right to a notice referred by law, the right to have the landlord maintain the property in a way that will prevent personal injury or damage to personal property, the right to appropriate legal procedures in any suit involving the tenant's rights and obligations, and the right to assert a cause of action against the landlord whenever it becomes necessary.

The tenant has the right to know who is authorized to manage the property and who is authorized to receive notices of termination, demands for repairs, and so on. He is entitled to "disclosure" of this information — to be furnished with the names and addresses of the appropriate people.

If the information is not given directly to the tenant, copies may be placed in every elevator plus one more conspicuous place in the building. If there are no elevators, copies must be placed in two or more conspicuous places in the building.

# 11

## ENCUMBRANCES

### INTRODUCTION

It is important for the real estate broker to understand the variety of encumbrances that affect title to property.

This chapter will discuss encumbrances, including liens, easements, encroachments, attachments, judgments, deed restrictions, CC&Rs, and special assessments.

### ENCUMBRANCES

#41 An encumbrance is anything that affects title to the property, such as tax liens or mortgages, and anything that affects the condition or use of the property, such as easements and building restrictions.

"Clouds on the title" look like encumbrances, but they can be eventually proved invalid. For instance, one of a group of owners may not yet have signed the deed of sale, or the owner may have paid off his mortgage although it has not yet been recorded officially.

### LIENS

A lien means the owner owes some money, and the person to whom he owes it has made his house the collateral for that debt. Liens can be voluntary or involuntary, general or specific.

#### (I) Voluntary and Involuntary Liens

A voluntary lien is one the owner creates of his own free will; for example, using the home as collateral for a mortgage or second trust deed.

An involuntary lien is charged against the property by someone other than the owner, such as a mechanic's lien for unpaid construction or remodeling costs.

#### (II) General and Specific Liens

Liens may be general if they affect everything owned by that

person, whether or not they are part of the lot in question. For example, unpaid federal income tax can mean a lien on every piece of property the person owns.

Liens are specific when they are charged against only one particular piece of property, as a mechanic's lien on the house he remodeled.

### TYPES OF LIENS

The most common types of liens are mechanic's liens and liens for taxes, although liens for other reasons are possible, too.

#### (I) Mechanic's Lien

A mechanic's lien is a charge against the property for work done on it or to it or for the materials needed for that work. Any contractor, subcontractor, building supply, nursery, or other person or company connected with work on the property can file a mechanic's lien if he is not paid. If the contractor does not pay his workers or those to whom he subcontracts work, the owner can still be held liable even though he paid the contractor in full. Many owners ask a contractor to post bond to guarantee that the workers will be paid and will not put mechanic's liens on the property.

The person filing a mechanic's lien is paid only the amount of his goods or services.

(A) **Notice of mechanic's liens** - Preliminary notice of a lien must be filed promptly, which means within 20 days of when work began or material was delivered. These liens have priority over any other claims that were recorded or attached after work started. The notices must include when the work was done, a complete description and price of goods or services, name and address of the claimant (person filing lien) and of the person who hired him, and a statement that all bills must be paid in full or a mechanic's lien will be attached. This notice must be hand delivered or mailed (first class, certified, or registered).

much money in a year — taxes and interest are due.

### **(B) Other tax liens**

(1) **Federal income tax** - The federal government can impose liens for unpaid income taxes. These liens are not valid against security interests (mortgages), mechanic's liens, judgment liens, and purchasers of the property.

(2) **State tax** - The state government can impose a State Tax Lien, but with the same limitations as for a Federal Tax Lien.

(3) **Estate and gift taxes** - Estate and Gift Tax Liens may also be imposed. They are usually not recorded, unless the estate tax is being paid in installments.

### **(III) Lien Priorities**

County and municipal taxes rank highest. If there are successive tax liens — that is, a series of them — they are ranked in priority from newest (most recent) to oldest, with newest having first claim.

Other liens, including mortgages, normally have priority according to when they were created. Notice of a lien is extremely important in determining when a lien was created.

## **EASEMENTS**

When one person has the right to use another person's property for a special purpose, this is called an easement. An easement is an interest in the property, not ownership of it. This interest could be for use of land, air, water, underground space, etc.

### **(I) Appurtenant Easements**

An "appurtenant easement" benefits one person's land by the use of his neighbor's land. It always involves adjacent pieces of land with separate owners.

Appurtenant easements are sometimes referred to as "land burdens," "servitudes," or "easements appurtenant".

(A) **Rights-of-way and party walls** - Appurtenant easements include rights-of-way and party walls. A right-of-way allows someone other than the owner to cross the land for his own purpose. Party walls are walls of buildings. They are built on the dividing line between two properties, are part of both buildings, and are owned by both sides.

(B) **Dominant and servient tenements** - The land that benefits from the easement is called the "dominant tenement". The land on which the easement runs is the "servient tenement".

Appurtenant easements are said to "run with the land". Since "appurtenant" means "belonging to," the easement continues to belong to the dominant tenement even if either the servient or the dominant tenement is sold or if both are sold. Actual title to the land the easement uses is held by the servient tenement, but it continues to be used by the dominant tenement.

### **(II) Easement in Gross**

Easements in gross do not involve neighboring landowners. They give right-of-way to people or companies. Easements in gross are considered personal rights, since they are attached to a particular person or company and not to a piece of land. Such easements belong to public utilities, railroads, airlines, cable television companies, etc.

Where utilities and other commercial enterprises are concerned, easements in gross continue regardless of who owns the property. They are therefore encumbrances. Easement in gross given to a specific person usually terminates when that person dies.

### **(III) Creation of Easements**

Easements can be created by agreement in writing between the two parties, either establishing that the easement exists and is recognized and accepted by both, or expressly granting the easement, that is, giving easement rights to the non-owner.

An easement on the property being sold can be reserved (kept) by the seller if he still has adjacent property or has sold only part of his lot. The seller could instead grant (give) an easement on his own property to the new owner of the property he is selling.

Easements can be by prescription, implication, or necessity. They can also arise from estoppel, sale of land according to a plat, condemnation, or dedication. Many times an easement develops from long-term use of land.

(A) **Easement by prescription** - If someone continuously uses another person's land for a particular purpose for five or more years, the user has an easement by prescription, according to California law. The use has to have been without the owner's permission, visible, open, and notorious. In other words, the use, such as walking across a corner of the property in a short cut, has to be something the owner noticed or could have noticed easily.

Adverse Possession # 80  
pay tax too

This use is an assertion of a private right by one or more persons, a claim by them, as shown by their actions, to the right to use someone else's property. Their use of the property has to continue without interruption for those five years.

**(B) Easement by implication** - If land is subdivided, certain easements may be implied, and may be given implied grants by law, if some portions of the land are used to benefit other portions. Existing sewer lines, for example, would serve more than one lot of the subdivision and would therefore have an implied easement, or easement by implication.

**(C) Easement by necessity** - Easement by necessity is an appurtenant easement and occurs when some property owner has no access to a street or other public way except by going over someone else's property. This could happen if someone sells part of his land which does not border on a street or road.

**(IV) Termination of Easement**

The owner of the property on which the easement runs has limited means for terminating an easement on his own. He can sue to have the easement terminated, he can buy out the dominant tenement and merge the two properties, or he can take adverse possession of the easement. If the servient tenement is destroyed, the easement is terminated.

The person claiming the right to the easement can terminate it by expressly releasing the other party, by abandoning the easement, by not using it for five or more years, or by merging the two properties under his ownership.

Intention of the parties is the main criterion when the courts decide whether an easement has been terminated.

Personal easements in gross are terminated with the death of that person.

Sometimes "license" is confused with easement in gross. The main difference is that license can be canceled whenever the licensor decides to do it. License could include permission to park on the golf course at Brookside Park while at a Rose Bowl game, or to use a neighbor's driveway for a garage sale, or to enjoy the show and facilities of a theater for which one has tickets.

**ENCROACHMENTS**

Encroachments are walls, buildings, fences, etc., that extend over the property line. They could extend into land belong-

ing to another person or into public land such as a street or alley. When a house is being sold, encroachment will show up when the property is surveyed.

If suit is brought, the courts could order the encroaching item removed, or they could order that damages be paid. If it costs a lot to remove the encroachment, if it does not encroach much, and if it was due to an excusable mistake, the courts will probably allow the encroachment to remain, but they will usually order damages to be paid.

An encroachment that has been unchallenged for five years or more can be considered an easement by prescription.

**ATTACHMENTS**

An attachment means property cannot be sold. Technically, the law attaches (seizes) the property and holds it until the courts have made a decision about it.

**(I) Why Attached**

Property can be attached when one person is suing another and wants to be sure the person being sued, if he loses, can pay off (will still have the property or assets necessary to pay off) the judgment.

**(II) Avoiding Attachment/Declaration of Homestead**

In cases of extreme hardship, the person being sued can file to have certain property exempted from attachment. Instead of or in addition to this, he can make his home a homestead, since homesteads cannot be attached. Certain forms must be filed for declaration of homestead.

A person can declare a dwelling to be a homestead if it is occupied by himself and/or a spouse, with or without children, grandchildren, parents, or grandparents. The relationship may be direct or through a former spouse, which means an ex-wife's father would be acceptable as a relative.

"Dwelling" includes house, condominium, stock cooperative, and mobile home. It may or may not include a boat that is used regularly as a residence.

There is a limit to the dollar amount of the property that can be homesteaded; it is currently \$50,000 or \$75,000, depending on age and family status.

Property that has been homesteaded can be encumbered or sold. If it is sold, the homestead is terminated. Homestead can also be terminated by execution sale or by abandonment (with the owner filing appropriate forms).

## JUDGMENTS

Courts can, of course, find judgments against the person being sued. If they do, then that person has to pay, or return property, or do whatever the judgment calls for.

Judgments can be appealed, so if property was attached to pay for the judgment, that property generally remains attached until the judgment can no longer be appealed.

Liens for judgment are not just on the real property a person owns at the time of judgment, but also on any real property he acquires for ten years following judgment.

The person can avoid a lien for judgment or have it removed by paying the judgment, posting security or money to pay for it, or having judgment stayed (stopped) by appealing it.

## RESTRICTIONS

Restrictions can be private agreements recorded as part of a deed, or public controls limiting use of land.

### (I) Private Agreements

Private agreements are sometimes referred to as "CC&Rs", or "covenants, conditions, and restrictions".

#97 (A) Covenants - Covenants are promises to do or not to do something. They are binding on the promisor, but not usually on anyone after him. Only rarely do they "run with the land", that is, carry over from one person to another as they come into possession of the property. Unlawful or impossible covenants are void.

Grant deeds are covenants of a sort. They are presumed to be a guarantee that the seller has hidden no encumbrances and has not already sold the land to someone else.

Someone guilty of breach of covenant may have to pay damages and still keep his promise.

(B) Conditions - Conditions are qualifications rather than promises.

(1) "**Run with the land**" - Title to an estate may depend on meeting certain conditions. These conditions "run with the land", that is, they continue indefinitely, regardless of who has possession of the land. Someone guilty of breach of condition would forfeit title to the land.

(2) **Condition precedent or subsequent** - The conditions may have to be met before or after title is trans-

ferred. If all payments must be made or all conditions must be met before title is transferred, this is "condition precedent". If title transfers immediately, but is to be forfeited if there is a breach of condition, this is "condition subsequent".

(3) "**In restraint of alienation**" - Sometimes conditions are set that are "in restraint of alienation." "Alienation" is a synonym for "conveyance", so "in restraint of alienation" means that title is supposed to transfer only if some unacceptable restrictions are fulfilled. These conditions are therefore void. So are illegal or impossible conditions.

(C) Deed restrictions — Deed restrictions are private agreements that affect the way land is used. A deed to property in a subdivision, for example, may require that the house be in a certain architectural style or that the property have certain features in order to keep the area uniform in appearance.

As long as deed restrictions are reasonable, adequately limited in scope and in time, and not in violation of federal or state regulations, they are enforceable.

If someone is in violation of deed restrictions, his neighbors can get a court injunction to stop him. If they do not act promptly when they see the violation, they may lose the right to complain. The legal term for this is "laches", the loss of a right because of failure to assert it or because of too long a delay in asserting it.

If the neighborhood has changed so much that restrictions which were once reasonable are no longer appropriate, they become unenforceable.

(D) Canceling restrictions - Restrictions can be canceled or terminated in several ways. They may be canceled voluntarily by the people involved or by act of government. Their terms may expire, or the conditions which they were created to meet may change. In this case, the courts may have to decide legality.

Conditions are automatically canceled when restricted property becomes owned by the person making the restrictions.

If restrictions involved only one property, the grantor can terminate them by quitclaim deed. If the restrictions involved neighboring houses, as in a subdivision, all the affected property owners must sign quitclaim deeds before termination is possible.



# 12

## PUBLIC CONTROLS

### INTRODUCTION

Public control of private lands is on the increase, due to increased awareness of various needs — to protect the environment, to prevent urban blight, to improve health conditions, to protect against earthquake damage, and so on.

The general purpose of all public controls, which are often referred to as “police power”, is to promote the general welfare. Through a series of “enabling acts”, police power is passed from the state to the various counties and municipalities.

Public controls of property include zoning restrictions; building, safety, and public health codes; contractors’ license laws; environmental protection; city plans; redevelopment; eminent domain; and subdivision regulations. All of these will be discussed in this chapter.

### ZONING RESTRICTIONS

Local governments, such as cities and counties, can regulate use of land through zoning restrictions or ordinances. These ordinances must be reasonable and must be designed to benefit “public health, safety, and general welfare”. They must also fit in with California’s general plan or they do not take effect. They must be free from discrimination of all kinds, as well as clear and specific.

#### (I) Types of Zoning

Zoning comes in a wide variety of forms. It can be aesthetic, requiring new buildings to use only certain types of architecture; developmental; inclusionary; incentive, requiring that ground floors of office buildings be used as retail stores; floating; or bulk, which controls population density.

Often zoning ordinances divide land use into categories — commercial, industrial, residential, and sometimes multi-use. “Commercial” includes shopping areas; “industrial” is

generally for factories; “residential” includes homes, apartments, and condominiums. All categories can be further limited, as, for example, single-family homes, high-rise apartments, etc. Residential areas usually have certain areas set aside for school, church, hospital, etc., even though these are not residential in nature. “Multi-use” zoning permits development of planned units.

No standard symbols exist in zoning — the same letter of the alphabet may mean different things in different communities. This can create misunderstandings if any of the people involved are from another community.

Property that existed before an area was zoned may be out of compliance. Usually the owner can be exempted for “nonconforming use”. If the building is destroyed, however, the new one built to replace it will have to conform.

#### (II) Variations

Zoning plans can change and property can be re-zoned. The property owner is not compensated for any change this brings to the value of his property. Anyone who is inconvenienced by re-zoning can apply to the local zoning board for a variance or for a conditional-use permit.

(A) **Variances** - People who want to use land in some way for which it has not been zoned must get a variance. This permits them to proceed as planned. Variances are usually granted as long as the proposed use is not out of harmony with the rest of the area and is not opposed to the public welfare. Such variances are sometimes referred to as “spot-zoning”.

(B) **Conditional-use permits** - Conditional-use permits allow property to be used for public welfare even though it is contrary to zoning ordinances. Therefore, a restaurant could be built in an industrial area provided that the workers needed it for meals.

days of subdivisions. Therefore it regulates conditions for sale or lease of subdivided real estate.

# 98 This law defines a subdivision as “five or more lots or parcels” and exempts any parcels of 160 acres and over, provided that they are designated that way by government survey. It includes such areas as undivided interests, agricultural leases, time-shares, community apartments, stock cooperatives, condominiums, limited equity housing cooperatives, long-term leasing of space in mobilehome parks, and “proposed divisions”. Most of these were discussed under “Types of Subdivisions”.

The law does not include leasing apartments, stores, offices, etc., in apartment buildings, commercial buildings, or industrial buildings, and it exempts subdivisions zoned expressly for commercial or industrial purposes. It does not require that subdivided lands be contiguous, that is, touching or adjoining.

### (I) Public Report

Any subdivision offered for sale in California — whether the land itself is in California or not — must have a subdivision public report issued by the Real Estate Commissioner before sales can begin. This report is a disclosure statement and is issued only when the commissioner feels satisfied that the property will be used as advertised, has met all statutory requirements, and has adequate financing for completion and maintenance. The disclosure statement also serves as notice that the property is available for sale.

All prospective buyers must receive a copy of the public report and must have a chance to read it thoroughly before signing the final contract. This is the report that shows any negative aspects of the proposed subdivision properties.

The public report usually includes the subdivider’s name, name of the project, location and size of the property being offered, what interest the buyer or lessee will acquire, how funds (taxes, purchase money, etc.) will be handled, and any special information the buyer should know.

Special information includes any hazards or restrictions, such as unusual easements or setbacks, restrictions on buyers (no rooftop TV antennas, no pets, etc.) and unusual financial arrangements.

### (II) Standards

In order to have a public report issued for it, a proposed subdivision must meet all the “affirmative standards” of the Subdivided Lands Law — requirements further explained in various real estate regulations as set forth by the commis-

sioner. These affirmative standards consider whether the land is suitable for its intended use and whether the proposed sale or lease of the property offers a fair deal.

For example, if residential property is suitable for its intended use, there will be good drinking water (potable water) and public utilities available, access for cars and other vehicles, and off-site improvements.

The “fair-deal” portion of the Subdivided Lands Law is designed to make sure the buyer will get clear title to the property and will find everything just as he expects it. The property, especially if it is out-of-state, may be appraised, with a full appraisal report submitted, to see if the asking price is reasonable.

Each type of subdivision is covered by certain sections of the Business and Professions Code and must meet the affirmative standards set out there. Undivided interests and land projects are also covered by certain sections of the Commissioner’s Regulations.

### (III) Special Considerations

Subdividers need to be aware of the environment and of laws that have been enacted to protect it.

**(A) California Coastal Zone Conservation Act** - Preservation of coastal areas rests in the hands of local governments, according to the California Coastal Zone Act. These local governments are supposed to have permanent plans for conservation. Any subdivision plans within the zone must be approved by local boards and will require either a special permit for development in the zone or some form of exemption.

The coastal zone is a strip of land about 1,000 yards wide, bordering the sea and running the entire length of the state. Areas with wildlife habitats, recreational areas, and estuaries may be wider. The zone has about 1,800 square miles of land.

**(B) Earthquakes** - The Alquist-Priolo Special Studies Zones Act controls development around earthquake faults. It was adopted on May 4, 1975, and applies to any development since that date, but not to any developments before that date. Fault zones are usually a quarter of a mile or more in width, with the fault line in the center. Maps of “special studies zones” may be studied at an office of California Division of Mines and Geology.

**(C) Environmental Impact Reports** - Subdividers may have to file Environmental Impact Reports before their subdivision plans will be approved.

The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

As defined in § 3602(h), 'Handicap' means, with respect to a person-

- (1) a physical or mental impairment which substantially limits one or more of such person's major life activities,
- (2) a record of having such an impairment, or
- (3) being regarded as having such an impairment, but such term does not include current, illegal use of or addiction to a controlled substance as defined in § 802 of Title 21.

The act is very specific in clarifying what is meant by the term physical or mental impairment in an effort to minimize unrelated complaints. §6(b)(3) even goes so far as to state, Neither the term 'individual with handicaps' nor the term 'handicap' shall apply to any individual solely because that individual is a transvestite.

Finally, certain exemptions are provided for in the act. § 3607 provides for a religious organization or private club exemption. Of major interest to some real estate agents, § 3605(c) allows for the following exemption in the appraisal of property. Nothing in this subchapter prohibits a person engaged in the business of furnishing appraisals of real property to take into consideration factors other than race, color, religion, national origin, sex, handicap, or familial status.

Between the various laws and the court cases, discrimination in housing of all origins have been outlawed. All real estate licensee must strictly comply with these federal rules.

## STATE LEVEL

To further insure that everyone in California receives the opportunity for fair housing, the California Legislature and the Real Estate Commissioner have enacted several measures. In this section, we will discuss the applicable state statutes and any pertinent court cases.

### CALIFORNIA BUSINESS AND PROFESSIONS CODE

The California Business and Professions Code contain two sections of particular importance to our discussion. It

should be noted that other sections of this code will be discussed in the section on ethics. § 125.6 states, #12

Every person who holds a license under the provisions of this code is subject to disciplinary action under the disciplinary provisions of this code applicable to such person if, because of the applicant's race, color, sex, religion, ancestry, physical handicap, marital status, or national origin, he or she refuses to perform the licensed activity or aids or incites the refusal to perform such licensed activity by another licensee, or if, because of the applicant's race, color, sex, religion, ancestry, physical handicap, marital status, or national origin, he or she makes any discrimination, or restriction in the performance of the licensed activity. Nothing in this section shall be interpreted to apply to discrimination by employers with regard to employees or prospective employees, nor shall this section authorize action against any club license issued pursuant to Article 4 (commencing with Section 23425) of Chapter 3 of Division 9 because of discriminatory membership policy. The presence of architectural barriers to the physically handicapped person which conform to applicable state or local building codes and regulations shall not constitute discrimination under this section. #19

It shall not constitute discrimination under this section for a person licensed pursuant to Division 2 (commencing with Section 500) to refuse to perform a licensed activity if the licensee determines that because of the relation between the licensed activity sought and the physical handicap, the licensed activity sought is beyond the licensee's skill, or could better be performed by another licensee. ...

'Physical handicap,' as used in this section, includes impairment of sight, hearing or speech, or impairment of physical ability because of amputation or loss of function or coordination, or any other health impairment which requires special education or related services.

The second section we need to consider from this state code is § 10177(l). According to it,

The Commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant, who has done, or may suspend or revoke the license of, or deny the issuance of a license to, a corporate applicant if an officer, director, or person owning or controlling 10 percent or more of the corporation's stock has done, any of the following: ...

shall monitor and investigate the lending patterns and practices of financial institutions for compliance with this part, including the lending patterns and practices for housing accommodations which are not occupied by the owner. If a finding is made that such patterns or practices violate the provisions of this part, the Secretary or the Secretary's designee shall take such action as will effectuate the purposes of this part. In addition to other remedies provided by this part or other provisions of law, the Secretary may recommend to the State Treasurer that state funds not be deposited in a financial institution where the Secretary has made a finding that such financial institution has engaged in a lending pattern and practice which violates the provisions of this part.

#### CHAPTER 4. COMPLAINT RESOLUTION

... § If... the Secretary finds that a financial institution has engaged in any unlawful practice as defined in this part, the Secretary shall ... take one on the following steps ... :

(a) The making of the financial assistance or the making of the financial assistance on nondiscriminatory terms; or

(b) The payment of damages to the complainant in an amount not to exceed one thousand dollars (\$1,000), if the Secretary finds that effective relief under subdivision (a) is no longer available.

One of your clients may feel that he has been discriminated against by a lender. Your help may be requested. Knowledge of the above provisions will assist you in informing your client of his rights. However, do not give any legal advice. To play it safe, the client should consult with a competent legal professional.

#### CALIFORNIA GOVERNMENT CODE

For our purposes, § 12900 to § 12995 of this code pertain the most to fair housing. Together, they comprise the California Fair Employment and Housing Act. They expand the application of the Rumford Act.

#### GENERAL PROVISIONS

§ 12900. This part may be known and referred to as the 'California Fair Employment and Housing Act...'

## FAIR HOUSING LAW

### DEFINITIONS

12927. As used in this part in connection with housing accommodations, unless a different meaning clearly appears from the context:

(a) 'Affirmative actions' means any activity for the purpose of eliminating discrimination in housing accommodations because of race, color, religion, sex, marital status, national origin, or ancestry....

~~(c) 'Discrimination' includes refusal to sell, rent, or lease housing accommodations; includes refusal to negotiate for the sale, rental, or lease of housing accommodations; includes representation that a housing accommodation is not available for inspection, sale, or rental when such housing accommodation is in fact so available; includes any other denial or withholding of housing accommodations; includes provisions of inferior terms, conditions, privileges, facilities, or services in connection with such housing accommodations; includes the cancellation or termination of a sale or rental agreement; and includes the provision of segregated or separated housing accommodations. The term 'discrimination' does not include refusal to rent or lease a portion of an owner-occupied single-family house to a person as a roomer or boarder living within the household, provided that no more than one roomer or boarder is to live within a household....~~

~~(e) 'Owner' includes the lessee, sublessee, assignee, managing agent, real estate broker or salesman, or any person having any legal or equitable right or ownership or possession or the right to rent or lease housing accommodations, and includes the state and any of its political subdivisions and any agency thereof.~~

### PROHIBITIONS

§ 12955. It shall be unlawful:

~~(a) For the owner of any housing accommodation to discriminate against any person because of race, color, religion, sex, marital status, national origin, or ancestry of such person.~~

~~(b) For the owner of any housing accommodation to make or to cause to be made any written or oral inquiry concerning the race, color, religion, sex, marital status, national origin, or ancestry of any person seeking to purchase, rent or lease any housing accommodation.~~

(c) ~~For any person to make, print, or publish, or cause to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a housing accommodation that indicates any preference, limitation, or discrimination based on race, color, religion, sex, marital status, national origin, or ancestry or an intention to make any such preference, limitation, or discrimination.~~

(d) For any person subject to the provisions of Section 51 of the Civil Code, as that section applies to housing accommodations, as defined in this part, to discriminate against any person because of race, color, religion, sex, marital status, national origin, or ancestry with reference thereto.

(e) For any person, bank, mortgage company or other financial institution to whom application is made for financial assistance for the purchase, organization, or construction of any housing accommodation to discriminate against any person or group of persons because of the race, color, religion, sex, marital status, national origin, or ancestry of such person or persons, or of prospective occupants or tenants, in the terms, conditions, or privileges relating to the obtaining or use of any such financial assistance.

(f) For any owner of housing accommodations to harass, evict, or otherwise discriminate against any person in the sale or rental of housing accommodations when the owner's dominant purpose is retaliation against a person who has opposed practices unlawful under this section, informed law enforcement agencies of practices believed unlawful under this section, or has testified or assisted in any proceeding under this part. Nothing herein is intended to cause or permit the delay of an unlawful detainer action.

(g) For any person to aid, abet, incite, compel, or coerce the doing of any of the acts or practices declared unlawful in this section, or to attempt to do so.

#### COMMISSION'S ACTIONS-PENALTIES

§ 12987. If the Commission, after hearing, finds that a respondent has engaged in any unlawful practice as defined in this part, the Commission shall state its findings of fact and shall issue and cause to be served on such respondent an order requiring such respondent to cease and desist from such practice and to take such actions, as, in the judgment of the Commission,

will effectuate the purpose of this part, including, but not limited to, any of the following:

(1) The sale or rental of the housing accommodation if it is still available, or the sale or rental of a like housing accommodation, if one is available, or the provision of financial assistance, terms, conditions, or privileges previously denied in violation of subdivision (f) of Section 12955 in the purchase, organization, or construction of the housing accommodation, if available.

(2) The payment of punitive damages in an amount not to exceed one thousand dollars (\$1,000), adjusted annually in accordance with the Consumer Price Index, and the payment of actual damages.

(3) Affirmative or prospective relief.

However, no remedy shall be available to the aggrieved person unless the aggrieved person waives any and all rights or claims under Section 52 of the Civil Code prior to receiving a remedy, and signs a written waiver to that effect.

The Commission may require a report of the manner of compliance.

If the Commission finds that a respondent has not engaged in any practice which constitutes a violation of this part, the Commission shall state its findings of fact and shall issue and cause to be served on the complainant an order dismissing the said accusation as to such respondent.

Any order issued by the Commission shall have printed on its face references to the provisions of the Administrative Procedure Act which prescribe the rights of appeal of any party to the proceeding to whose position the order is adverse.

The Attorney General provided an interpretation which is of special interest to all real estate agents. In SO73-19, 56 Op. Atty. Gen. 546, it was concluded that an agent cannot furnish the ethnic or race background of a prospective renter or purchaser even if requested. Breach of this duty can result in severe legal actions. Be very careful when informing your principals of any third parties. Further clarification of this act was provided by the case of **Hess v. Fair Employment and Housing Commission**, 187 Cal. Rptr. 712, 138 C.A. 232. In it, the court ruled that the application of the prohibition against discrimination based on marital status extends to unmarried couples.

#### REGULATIONS OF THE CALIFORNIA REAL ESTATE

COMMISSIONER

In an effort to further apply discrimination prohibitions to the real estate agent, the Real Estate Commissioner enacted § 2780 through § 2782. They are contained in the California Administrative Code.

#6

**§ 2780 DISCRIMINATORY CONDUCT AS THE BASIS FOR DISCIPLINARY ACTION.**

Prohibited discriminatory conduct by a real estate licensee based upon race, color, sex, religion, ancestry, physical handicap, marital status or national origin includes, but is not limited to, the following:

(a) Refusing to negotiate for the sale, rental or financing of the purchase of real property or otherwise making unavailable or denying real property to any person because of such person's race, color, sex, religion, ancestry, physical handicap, marital status or national origin.

~~(b) Refusing or failing to show, rent, sell or finance the purchase of real property to any person or refusing or failing to provide or volunteer information to any person about real property, or channeling or steering any person away from real property, because of that person's race, color, sex, religion, ancestry, physical handicap, marital status or national origin or because of the racial, religious, or ethnic composition of any occupants of the area in which the real property is located.~~

It shall not constitute discrimination under this subdivision for a real estate licensee to refuse or fail to show, rent, sell or finance the purchase of real property to any person having a physical handicap because of the presence of hazardous conditions or architectural barriers to the physically handicapped which conform to applicable state or local building codes and regulations.

(c) Discriminating because of race, color, sex, religion, ancestry, physical handicap, marital status or national origin against any person in the sale or purchase or negotiation or solicitation of the sale or purchase or the collection of payment or the performance of services in connection with contracts for the sale of real property or in connection with loans secured directly or collaterally by liens on real property or on a business opportunity.

Prohibited discriminatory conduct by a real estate licensee under this subdivision does not include acts based on a person's marital status which are reasonably

taken in recognition of the community property laws of this state as to the acquiring, financing, holding or transferring of real property.

(d) Discriminating because of race, color, sex, religion, ancestry, physical handicap, marital status or national origin against any person in the terms, conditions or privileges of sale, rental or financing of the purchase of real property.

This subdivision does not prohibit the sale price, rent or terms of a housing accommodation containing facilities for the physically handicapped to differ reasonably from a housing accommodation not containing such facilities.

(e) Discriminating because of race, color, sex, religion, ancestry, physical handicap, marital status or national origin against any person in providing services or facilities in connection with the sale, rental or financing of the purchase of real property, including but not limited to: processing applications differently, referring prospects to other licensees because of the prospects' race, color, sex, religion, ancestry, physical handicap, marital status or national origin, using with discriminatory intent or effect, codes or other means of identifying minority prospects, or assigning real estate licensees on the basis of a prospective client's race, color, sex, religion, ancestry, physical handicap, marital status or national origin.

Prohibited discriminatory conduct by a real estate licensee under this subdivision does not include acts based on a person's marital status which are reasonably taken in recognition of the community property laws of this state as to the acquiring, financing, holding or transferring of real property.

#7

~~(f) Representing to any person because of his or her race, color, sex, religion, ancestry, physical handicap, marital status or national origin that real property is not available for inspection, sale or rental when such real property is in fact available.~~

~~(g) Processing an application more slowly or otherwise acting to delay, hinder or avoid the sale, rental or financing of the purchase of real property on account of the race, color, sex, religion, ancestry, physical handicap, marital status or national origin of a potential owner or occupant.~~

(h) Making any effort to encourage discrimination against persons because of their race, color, sex, religion, ancestry, physical handicap, marital sta-

tus or national origin in the showing, sale, lease or financing of the purchase of real property.

~~(i) Refusing or failing to cooperate with or refusing or failing to assist another real estate licensee in negotiating the sale, rental or financing of the purchase of real property because of the race, color, sex, religion, ancestry, physical handicap, marital status or national origin of any prospective purchaser or tenant.~~

(j) Making any effort to obstruct, retard or discourage the purchase, lease or financing of the purchase of real property by persons whose race, color, sex, religion, ancestry, physical handicap, marital status or national origin differs from that of the majority of persons presently residing in a structural improvement to real property or in an area in which the real property is located.

(k) Performing any act, making any notation, asking any questions or making or circulating any written or oral statement which when taken in context, expresses or implies a limitation, preference or discrimination based upon race, color, sex, religion, ancestry, physical handicap, marital status or national origin; provided, however, that nothing herein shall limit the administering of forms or the making of a notation required by a federal, state or local agency for data collection or civil rights enforcement purposes; or in the case of a physically handicapped person, making notation, asking questions or circulating any written or oral statement in order to serve the needs of such a person.

(l) Making any effort to coerce, intimidate, threaten or interfere with any person in the exercise or enjoyment of, or on account of such person's having exercised or enjoyed, or on account of such person's having aided or encouraged any other person in the exercise or enjoyment of any right granted or protected by a federal or state law, including but not limited to: assisting in any effort to coerce any person because of his or her race, color, sex, religion, ancestry, physical handicap, marital status or national origin to move from, or to not move into, a particular area; punishing or penalizing real estate licensees for their refusal to discriminate in the sale or rental of housing because of the race, color, sex, religion, ancestry, physical handicap, marital status or national origin of a prospective purchaser or lessee; or evicting or taking other retaliatory action against any person for having filed a fair housing complaint or for having undertaken other lawful

efforts to promote fair housing.

(m) Soliciting of sales, rentals or listings of real estate from any person, but not from another person within the same area because of differences in the race, color, sex, religion, ancestry, physical handicap, marital status or national origin of such persons.

(n) Discriminating because of race, color, sex, religion, ancestry, physical handicap, marital status or national origin in informing persons of the existence of waiting lists or other procedures with respect to the future availability of real property for purchase or lease.

(o) Making any effort to discourage or prevent the rental, sale or financing of the purchase of real property because of the presence or absence of occupants of a particular race, color, sex, religion, ancestry, physical handicap, marital status or national origin, or on the basis of the future presence or absence of a particular race, color, sex, religion, ancestry, physical handicap, marital status or national origin, whether actual, alleged or implied.

(p) Making any effort to discourage or prevent any person from renting, purchasing or financing the purchase of real property through any representations of actual or alleged community opposition based upon race, color, sex, religion, ancestry, physical handicap, marital status or national origin.

(q) Providing information or advice to any person concerning the desirability of particular real property or a particular residential area(s) which is different from information or advice given to any other person with respect to the same property or area because of differences in the race, color, sex, religion, ancestry, physical handicap, marital status or national origin of such persons.

This subdivision does not limit the giving of information or advice to physically handicapped persons for the purpose of calling to the attention of such persons the existence or absence of housing accommodation services or housing accommodations for the physically handicapped.

(r) Refusing to accept a rental or sales listing or application for financing of the purchase of real property because of the owner's race, color, sex, religion, ancestry, physical handicap, marital status or national origin or because of the race, color, sex, religion, ancestry, physical handicap, marital

of ruling on ethical questions regarding real estate licensees, the Commissioner's Regulations carry a great amount of weight. Also, they are the most pervasive since they apply to all real estate licensees. Read them carefully!

**§ 2785. CODE OF ETHICS AND PROFESSIONAL CONDUCT.**

In order to enhance the professionalism of the California real estate industry, and maximize protection for members of the public dealing with real estate licensees, the following standards of professional conduct and business practices are adopted:

**(a) UNLAWFUL CONDUCT.** Licensees shall not engage in 'fraud' or 'dishonest dealing' or 'conduct which would have warranted the denial of an application for a real estate license' within the meaning of Business and Professions Code Section 10176 and 10177 including, but not limited to, the following acts and omissions:

#276 (1) Knowingly making a substantial misrepresentation of the likely market value of real property to its owner either for the purpose of securing a listing or for the purpose of acquiring an interest in the property for the licensee's own account.

(2) The statement or implication by a licensee to an owner of real property during listing negotiations that the licensee is precluded by law, regulation or by the rules of any organization, other than the broker firm seeking the listing, from charging less than the commission or fee quoted to the owner by the licensee.

(3) The failure by a licensee acting in the capacity of an agent in a transaction for the sale, lease or exchange of real property to disclose to a prospective purchaser or lessee facts known to the licensee materially affecting the value or desirability of the property, when the licensee has reason to believe that such facts are not known to, nor readily observable by a prospective purchaser or lessee.

(4) When seeking a listing, representation to an owner of the real property that the soliciting licensee has obtained a bona fide written offer to purchase the property, unless at the time of the representation the licensee has possession of a bona fide written offer to purchase.

(5) The willful failure by a listing broker to present or cause to be presented to the owner of the property any offer to purchase received prior to the closing of a sale, unless expressly instructed by the

owner not to present such an offer, or unless the offer is patently frivolous.

(6) Presenting competing offers to purchase real property to the owner by the listing broker in such a manner as to induce the owner to accept the offer which will provide the greatest compensation to the listing broker, without regard to the benefits, advantages, and/or disadvantages to the owner.

(7) Knowingly underestimating the probable closing costs in a transaction in a communication to the prospective buyer or seller of real property in order to induce that person to make or to accept an offer to purchase the property.

(8) Failing to explain to the parties or prospective parties to a real estate transaction the meaning and probable significance of a contingency in an offer or contract that the licensee knows or reasonably believes may affect the closing date of the transaction, or the timing of the vacating of the property by the seller or its occupancy by the buyer.

(9) Knowingly making a false or misleading representation to the seller of real property as to the form, amount and/or treatment of a deposit toward purchase of the property made by an offeror.

(10) The refunding by a licensee, when acting as an agent or subagent for seller, of all or part of an offeror's purchase money deposit in a real estate sales transaction after the seller has accepted the offer to purchase, unless the licensee has the express permission of the seller to make the refund.

(11) Failing to disclose to the seller of real property in a transaction in which the licensee is acting in the capacity of an agent, the nature and extent of any direct or indirect interest that the licensee expects to acquire as a result of the sale. The prospective purchase of the property by a person related to the licensee by blood or marriage, purchase by an entity in which the licensee has an ownership interest, or purchase by any other person with whom the licensee occupies a special relationship where there is a reasonable probability that the licensee could be indirectly acquiring an interest in the property, shall be disclosed.

(12) A representation made as principal or agent to a prospective purchaser of a promissory note secured by real property with respect to the fair market value of the securing property without a reasonable basis for believing the truth and accuracy of the estimate of fair market value.



(13) Making an addition to or modification of the terms of an instrument previously signed or initialed by a party to a transaction without the knowledge and consent of the party.

**(b) UNETHICAL CONDUCT.** In order to maintain a high level of ethics in business practice, real estate licensees should avoid engaging in any of the following activities:

- (1) Representing, without a reasonable basis, the nature and/or condition of the interior or exterior features of a property when soliciting an offer.
- (2) Failing to respond to reasonable inquiries of a principal as to the status or extent of efforts to market property listed exclusively with the licensee.
- (3) Representing as an agent that any specific service is free when, in fact, it is covered by a fee to be charged as part of the transaction.
- (4) Failing to disclose to a person when first discussing the purchase of real property, the existence of any direct or indirect ownership interest of the licensee in the property.
- (5) Recommending by a salesperson to a party to a real estate transaction that a particular lender or escrow service be used when the salesperson believes his or her broker has a significant beneficial interest in such entity without disclosing this information at the time the recommendation is made.
- (6) Claiming to be an expert in an area of specialization in real estate brokerage, e.g., appraisal, property management, industrial siting, etc., if, in fact, the licensee has had no special training, preparation or experience in such area.
- (7) Using the term 'appraisal' in any advertising of offering for promoting real estate brokerage business to describe a real property evaluation service to be provided by the licensee unless the evaluation process will involve a written estimate of value based upon the assembling, analyzing and reconciling of facts and value indicators for the real property in question.
- (8) Failing to disclose to the appropriate regulatory agency any conduct on the part of a financial institution which reasonably could be construed as a violation of the Housing Financial Discrimination Act of 1977 (anti-redlining) Part 6 (commencing with Section 35800) of Division 24 of the

Health and Safety Code.

- (9) Representing to a customer or prospective customer that because the licensee or his or her broker is a member of, or affiliated with, a franchised real estate brokerage entity, that such entity shares substantial responsibility, with the licensee, or his or her broker, for the proper handling of transactions if such is not the case.
  - (10) Demanding a commission or discount by a licensee purchasing real property for one's own account after an agreement in principle has been reached with the owner as to the terms and conditions of purchase without any reference to price reduction because of the agent's licensed status.
- (c) BENEFICIAL CONDUCT.** In the best interests of all licensees and the public they serve, brokers and salespersons are encouraged to pursue the following beneficial business practices:
- (1) Measuring success by the quality and benefits rendered to the buyers and sellers in real estate transactions rather than by the amount of compensation realized as a broker or salesperson.
  - (2) Treating all parties to a transaction honestly.
  - (3) Promptly reporting to the California Department of Real Estate any apparent violations of the Real Estate Law.
  - (4) Using care in the preparation of any advertisement to present an accurate picture or message to the reader, viewer, or listener.
  - (5) Submitting all written offers as a matter of top priority.
  - (6) Maintain adequate and complete records of all one's real estate dealings.
  - (7) Keeping oneself current on factors affecting the real estate market in which the licensee operates as an agent.
  - (8) Making a full, open, and sincere effort to cooperate with other licensees, unless the principal has instructed the licensee to the contrary.
  - (9) Attempting to settle disputes with other licensees through mediation or arbitration.
  - (10) Complying with these standards of professional conduct, and the Code of Ethics of any organized real estate industry group of which the licensee is a member.

**ARTICLE 6**

To prevent dissension and misunderstanding and to assure better service to the owner, the REALTOR® should urge the exclusive listing of property unless contrary to the best interest of the owner.

**ARTICLE 7**

In accepting employment as an agent, the REALTOR® pledges himself to protect and promote the interests of the client. The obligation of absolute fidelity to the client's interest is primary, but it does not relieve the REALTOR® of the obligation to treat fairly all parties to the transaction.

**ARTICLE 8**

The REALTOR® shall not accept compensation from more than one party, even if permitted by law, without the full knowledge of all parties to the transaction.

**ARTICLE 9**

The REALTOR® shall avoid exaggeration, misrepresentation, or concealment of pertinent facts. He has an affirmative obligation to discover adverse factors that a reasonably competent and diligent investigation would disclose.

**ARTICLE 10**

The REALTOR® shall not deny equal professional services to any person for reasons of race, creed, sex, or country of national origin. The REALTOR® shall not be a party to any plan or agreement to discriminate against a person or persons on the basis of race, creed or country of national origin.

**ARTICLE 11**

A REALTOR® is expected to provide a level of competent service in keeping with the Standards of Practice in those fields in which the REALTOR® customarily engages.

The REALTOR® shall not undertake to provide specialized professional services concerning a type of property or service that is outside of his field of competence unless he engages the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client. Any

person engaged to provide such assistance shall be so identified to the client and his contribution to the assignment should be set forth.

The REALTOR® shall refer to the Standards of Practice of the National Association as to the degree of competence that a client has a right to expect the REALTOR® to possess, taking into consideration the complexity of the problem, the availability of expert assistance, and the opportunities for experience available to the REALTOR®.

**ARTICLE 12**

The REALTOR® shall not undertake to provide professional services concerning a property or its value where he has a present or contemplated interest unless such interest is specifically disclosed to all affected parties.

**ARTICLE 13**

The REALTOR® shall not acquire an interest in or buy for himself, any member of his immediate family, his firm or any member thereof, or any entity in which he has a substantial ownership interest, property listed with him, without making the true position known to the listing owner. In selling property owned by himself, or in which he has any interest, the REALTOR® shall reveal the facts of his ownership or interest to the purchaser.

**ARTICLE 14**

In the event of a controversy between REALTORS® associated with different firms, arising out of their relationship as REALTORS®, the REALTORS® shall submit the dispute to arbitration in accordance with the regulations of their board or boards rather than litigate the matter.

**ARTICLE 15**

If a REALTOR® is charged with unethical practice or is asked to present evidence in any disciplinary proceeding or investigation, he shall place all pertinent facts before the proper tribunal of the member board of affiliated institute, society, or council of which he is a member.

**ARTICLE 16**

When acting as agent, the REALTOR® shall not accept any commission, rebate, or profit on expenditures

made for his principal-owner, without the principal's knowledge and consent.

#### ARTICLE 17

The REALTOR® shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it.

#### ARTICLE 18

The REALTOR® shall keep in a special account in an appropriate financial institution, separated from his own funds, monies coming into his possession in trust for other persons, such as escrows, trust funds, clients' monies, and other like items.

#### ARTICLE 19

The REALTOR® shall be careful at all times to present a true picture in his advertising and representations to the public. He shall neither advertise without disclosing his name nor permit any person associated with him to use individual names or telephone numbers, unless such person's connection with the REALTOR® is obvious in the advertisement.

#### ARTICLE 20

The REALTOR®, for the protection of all parties, shall see that financial obligations and commitments regarding real estate transactions are in writing, expressing the exact agreement of the parties. A copy of each agreement shall be furnished to each party upon his signing such agreement.

#### ARTICLE 21

The REALTOR® shall not engage in any practice or take any action inconsistent with the agency of another REALTOR®.

#### ARTICLE 22

In the sale of property which is exclusively listed with a REALTOR®, the REALTOR® shall utilize the services of other brokers upon mutually agreed upon terms when it is in the best interests of the client.

Negotiations concerning property which is listed exclusively shall be carried on with the listing broker, not with the owner, except with the consent of the listing broker.

#### ARTICLE 23

The REALTOR® shall not publicly disparage the business practice of a competitor nor volunteer an opinion of a competitor's transaction. If his opinion is sought and if the REALTOR® deems it appropriate to respond, such opinion shall be rendered with strict professional integrity and courtesy.

#### RELATED CALIFORNIA LAW

~~§ 10176 and § 10177 of the California Business and Professions Code directly illustrate appropriate and inappropriate ethical behavior. They read as follows.~~

#### GROUND~~S~~ FOR REVOCATION OR SUSPENSION

§ 10176. The Commissioner may, upon his own motion, and shall, upon the verified complaint in writing of any person, investigate the actions of any person engaged in the business or acting in the capacity of a real estate licensee within this state, and he may temporarily suspend or permanently revoke a real estate license at any time where the licensee, while a real estate licensee, in performing or attempting to perform any of the acts within the scope of this chapter has been guilty of any of the following:

- (a) Making any substantial misrepresentation.
- (b) Making any false promises of a character likely to influence, persuade or induce.
- (c) A continued and flagrant course of misrepresentation or making of false promises through real estate agents or salesmen.
- (d) Acting for more than one party in a transaction without the knowledge or consent of all parties thereto.
- (e) Commingling with his own money or property the money or other property of others which is received and held by him.

(f) Claiming, demanding, or receiving a fee, compensation or commission under any exclusive agreement authorizing or employing a licensee to perform any acts set forth in Section 10131 for compensation or commission where such agreement does not contain a definite, specified date of final and complete termination.

(g) The claiming or taking by a licensee of any secret or undisclosed amount of compensation, commission or profit or the failure of a licensee to reveal to the employee of such licensee the full amount of such licensee's compensation, commission or profit under any agreement authorizing or employing such licensee to do any acts for which a license is required under this chapter for compensation or commission prior to or coincident with the signing of an agreement evidencing the meeting of the minds of the contracting parties, regardless of the form of such agreement, whether evidenced by documents in an escrow or by any other or different procedure.

(h) The use by a licensee of any provision allowing the licensee an option to purchase in an agreement authorizing or employing such licensee to sell, buy, or exchange real estate or a business opportunity for compensation or commission, except when such licensee prior to or coincident with election to exercise such option to purchase reveals in writing to the employer the full amount of licensee's profit and obtains the written consent of the employer approving the amount of such profit.

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

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

#### **§ 10177. GROUNDS**

The Commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant, who has done, or may suspend or revoke the license of, or deny the issuance of a license to, a corporate applicant if an officer, director, or person owning or controlling 10 percent or more of the corporation's stock has done, any of the following:

(a) Procured, or attempted to procure, a real estate license or license renewal, for himself or herself or any

salesperson, by fraud, misrepresentation or deceit, or by making any material misstatement of fact in an application for a real estate licensee, license renewal or reinstatement.

(b) Entered a plea of guilty or nolo contendere to, or been found guilty of, or been convicted of, a felony or a crime involving moral turpitude, and the time for appeal has elapsed or the judgment of conviction has been affirmed on appeal, irrespective of an order granting probation following such conviction, suspending the imposition of sentence, or of a subsequent order under the provision of Section 1203.4 of the Penal Code allowing such licensee to withdraw his or her plea of guilty and to enter a plea of not guilty, or dismissing the accusation or information.

(c) Knowingly authorized, directed, connived at or aided in the publication, advertisement, distribution, or circulation of any material false statement or representation concerning his business, or any business opportunity or and land or subdivision (as defined in Chapter 1 (commencing with Section 11000) of Part 2 of this division) offered for sale.

(d) Willfully disregarded or violated any of the provisions of the Real Estate Law (commencing with Section 10000 of this code) or of Chapter 1 (commencing with Section 11000) of Part 2 of this division or of the rules and regulations of the Commissioner for the administration and enforcement of the Real Estate Law and Chapter 1 (commencing with Section 11000) of Part 2.

(e) Willfully used the term 'realtor' or any trade name or insignia of membership in any real estate organization of which the licensee is not a member.

(f) Acted or conducted himself in a manner which would have warranted the denial of his or her application for a real estate license, or has either had a license denied or a license issued by another agency of this state, another state, or the federal government, revoked or suspended for acts which if done by a real estate licensee would be grounds for the suspension or revocation of a California real estate license; provided, however, that the action of denial, revocation, or suspension by the other agency or entity was taken only after giving the licensee or applicant fair notice of the charges, an opportunity for a hearing, and other due process protections comparable to the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code), and only upon an express finding

of a violation of law by the agency or entity.

(g) Demonstrated negligence or incompetence in performing any act for which he or she is required to hold a license.

(h) If, as a broker licensee, failed to exercise reasonable supervision over the activities of his or her salespersons or as the officer designated by a corporate broker licensee, failed to exercise reasonable supervision and control of the activities of the corporation for which a real estate license is required.

(i) Has used his or her employment by a governmental agency in a capacity giving access to records, other than public records, in such manner as to violate the confidential nature of such records.

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

(k) Violated any of the terms, conditions, restrictions, and limitations contained in any order granting a restricted license.

#15  
~~(l) Solicited or induced the sale, lease or the listing for sale or lease, of residential property on the ground, wholly or in part, of loss of value, increase in crime, or decline of the quality of the schools, due to the present or prospective entry into the neighborhood of a person or persons of another race, color, religion, ancestry or national origin.~~

(m) Violated any of the provisions of the Franchise Investment Law (Division 5 (commencing with Section 31000) of Title 4 of the Corporations Code) or any Regulations of the Commissioner of Corporations pertaining thereto.

(n) Violated any of the provisions of the Corporations Code or of the Regulations of the Commissioner of Corporations relating to securities as specified in Section 25206 of the Corporations Code.

The Commissioner may not deny or suspend the license of a corporate real estate broker if the offending officer, director, or stockholder has been completely disassociated from any affiliation or ownership in the corporation.

## PRACTICAL APPLICATIONS

To help you integrate the various codes of ethics and laws into your everyday business, this section will provide illustrative cases. It will cover the most troublesome areas.

### BROKER AS PURCHASER

As many professionals already know, it is imperative that in any transaction in which an agent is purchasing or selling property, he must reveal his status to all persons involved. § 2785(a)(11) and § 2875(b)(4) of the Commissioner's Regulations demonstrate this fact. Invariably, the failure to inform others participating in a transaction of his status will come back to haunt the agent. The courts have gone to great lengths to protect unknowing parties, even though the transaction appears fair and reasonable at the time of the original agreement.

Of course, it is easy for the licensee to follow the practice that whenever he is involving himself as a principal in a transaction, he should reveal his status as a licensee. Also, the licensee must reveal to others involved in the transaction that, for example, he is related to a prospective purchaser or seller, has an interest in the corporation which is attempting to buy or sell property, or is a partner in a firm which is buying or selling property.

In the case of **Whitehead v. Gordon, (1969) 82 Cal. Rptr. 778, 2 C.A.3d 659**, the degree of accountability of a licensee in this area was clearly illustrated. In that case, the agent submitted an offer on a probate sale on behalf of his broker-in-law. He did not reveal to the probate court that the purchaser was, in fact, his brother-in-law. After the sale of the property was confirmed by the court, an escrow was opened to complete the sale to the agent's brother-in-law. At the time, a second escrow was opened to transfer the property into a corporation in which the agent held an interest.

Because the agent did not reveal to the probate court or to the representative of the estate that the property would ultimately be purchased by a corporation in which the agent held an interest, the agent was disciplined with the suspension of his license. The fact that the agent had no exclusive listing with the estate for the sale of the property, but was merely acting pursuant to an open listing, was no defense to the charges levied against the agent.

Those charges included violations of Business and Professions Code § 10176(a), (d) and (i) and § 10177(f) and (j), dealing with misrepresentation, concealment of compensation, acting for more than one party, and dishonest dealing.

# 14

## PROPERTY MANAGEMENT

### HISTORICAL BACKGROUND AND JOB DESCRIPTION

The development of the profession of property management has been intimately connected with changes in the fluid and dynamic world of real estate over the course of the twentieth century. Originally, a property manager did little more than serve as a caretaker of investment property, performing routine maintenance and collecting rents. Technological and demographic developments, however, brought about radical and sweeping changes in the way we live and the way we use real estate, changes which in turn affected the role of the property manager. What began as a simple caretaker function has developed over the past several decades into a highly specialized, multi-skilled profession.

#  
28  
The development of steel construction, for example, which led to the erection of high rise multi-family dwellings, intensified the need for property management. As apartment buildings, cooperatives, and condominiums increased in size and complexity, as tenant populations grew, and as investments became more substantial, the skills required of property managers multiplied accordingly.

Another development which affected the real estate industry, and consequently the opportunities for property management, was the proliferation of private automobile transportation and the consequent move of the population from urban to suburban centers. Office buildings and regional shopping centers sprang up across the country, all requiring a steadily advancing degree of sophisticated scientific property management methods and skills.

Management of investment property has therefore become a highly specialized area of the real estate business. Arising as it has in an age of specialization in all fields of endeavor, this particular specialty would seem to be just another example of a national trend: as the demands of modern life and the application of scientific technologies and method-

ologies have required an ever increasing number of specialists in all fields, generalists in any endeavor have become increasingly rare.

Real estate, of course, has been no exception. People who make their livelihoods in the real estate industry respond to the increasing complexity of modern life in the same way, by recognizing special areas of need and opportunity and by filling those areas with specialists, such as property managers, who are experts in solving particular kinds of problems and providing certain services. The curious thing about property management as a specialty, however, is that it requires a very broad understanding of many other professions, crafts, and skills.

### PARADOX

The specialists known as a property manager must be a multi-disciplined generalist (paradoxical as that may sound) capable not only of marketing and sales strategies, but also complex record keeping and accounting, budgeting and economic forecasting, effective interpersonal communications, and high levels of analytical and organizational skills — a very sophisticated Jack-of-all-trades operating in one small area of real estate.

An effective property manager will be familiar with basic economic principles and the language and application of certain aspects of law. Those who manage shopping centers must understand the language and practices of the retail industry. Industrial property managers must learn negotiating skills in order to work out complex long-term leases between manufacturers and owners of industrial space. Marketing surveys have to be conducted, demographic information gathered and analyzed. Properties must be advertised and promoted. Above all, investor goals must be achieved.

provide the manager with the authority needed to comply with existing laws, codes and regulations. The owner will usually indemnify the agent against any liability suits in connection with the operation of the property, and to pay all expenses in any legal proceeding. All employees are considered those of the owner, not the manager.

The agreement will also specify monies which the owner agrees to pay to the agent on a monthly basis for such things as restoration, modernization, leasing activities, and management itself. Other than expenses directly related to the exercise of his duties, the agent will be forbidden to make any such expenditures as structural changes in the building, without prior written consent. Emergencies involving danger to life or property are, of course, excluded from this limitation.

There will probably also be a clause in the management agreement which allows the agent to cancel the agreement at such time as he considers the action or position of the owner, with respect to laws, ordinances, and regulations, a likely cause of damage or liability to the agent. Terms for the cancellation of the agreement by the owner will also be explained.

### AND THEN...

That would seem to cover the relationship between the owner and the manager/agent, and to explain in a general way what the manager's duties and responsibilities consist of. The administration of these duties, however, will involve a multitude of details. For example, in order to ensure compliance with the Federal Wage and Hour Act, the Workmen's Compensation Act, and the Occupational Safety and Health Act, it will be necessary frequently to monitor the work schedules of resident managers and to see that all employment contracts are properly signed and executed.

The execution of maintenance responsibility will require the preparation of daily, weekly, and monthly checklists which must be completed by the manager or designated employee. In addition, seasonal equipment, such as swimming pools, will require routine yearly inspections, reports, and service. Generally speaking, modern property management stresses the importance of preventive maintenance, which involves an ongoing system of monitoring the physical structure and operating mechanisms of the property.

Other ongoing activities which are necessary for the proper execution of the management agreement will include all or some of the following. An aware manager will routinely shop the competition in the neighborhood or general locale of the property in order to remain aware of the market and make adjustments in rent levels. Vacancies will be inspected, and

tenants who give notice of intent to vacate will be promptly interviewed to determine if there is a problem which can be solved to prevent the move. Every now and then petty cash funds must be audited. If leases are executed by resident managers, they must be spot checked for thoroughness and accuracy.

Inventory systems must be installed and maintained, and purchases must be carefully controlled in order to prevent redundant spending and to keep track of waste and/or pilferage. Charts need to be kept detailing monthly consumption of utilities, and proper controls and procedures must be put in place to ensure utility conservation.

In addition, a successful property manager will attend public meetings and seminars, association gatherings, and any open meetings of city councils and boards of supervisors which pertain to the business of real estate and property management.

### MANAGEMENT PRINCIPLES IN GENERAL

#57

It may be well at this point to separate the specifics of property management and set them aside for a brief discussion of management principles in general. An enormous number of books have been written on the subject, and new innovative management techniques are being designed and submitted to practice all the time, but there are certain things which can be said about management that are widely held to be valid, and worth mentioning in the context of property management itself.

A successful property manager will think above and beyond the specifics of his special enterprise, and will in addition consider how best to make use of the following principles or "truisms" of the discipline of management:

1. Short term goals, because of the prospect of early reward for effort expended, and because of a relatively smaller investment in time and money, have a tendency to displace or supersede long term goals. Frequently, short term goals will seem to be in direct conflict with long term goals. Balance must be achieved, intelligent compromise exercised, and long term goals protected.
2. It costs more in the long run to retain an unsatisfactory employee than it does to recruit and train someone new. The tendency, of course, is to make do with someone who is unsatisfactory, and the cost of so doing can be great.
3. All management objectives require resources; hence, there will be competition for resources. In this, tangible

goals will tend to win support over intangible goals; easily quantifiable goals will take precedence over less easily quantifiable goals; financial goals will often supersede personnel goals. It is important to seek the optimal result, bearing these tendencies in mind, assuring that different categories of goals are mutually supportive, and that traditionally neglected areas should get their due allocation of resources.

4. Goals which are unattainable are a waste of time and resources and produce nothing but frustration; goals which are too easy, even if only slightly, can be very costly. An example of the latter: Insufficient market research may result in establishing rent levels (a type of goal) below what is possible to achieve. To illustrate the point, consider for example a 100 unit apartment building where each unit rents for \$300 per month in an area which might realistically be expected to support 5% more than that (based on data that could be produced by a good market research plan). A five percent increase would raise the monthly rent per unit to \$315 per month, amounting to a monthly increase in rents for the whole building of \$1500. At \$300 per month, under these circumstances, the owner is losing \$18,000 per year. Of course, if the optimal rent is \$315, and if the manager sets the rent level at \$320, the result might very well be a high vacancy rate and a failure to achieve goals. To repeat: If the goals are too easy, success in achieving them may still result in a net loss; if goals are too difficult, there is a likelihood of frustration and loss. If the goals are impossible, disaster could be the result.

5. Time is a resource and must be managed very carefully. The very nature of the business of property management is such that every expenditure of time is costly and every opportunity for wasted time is present every day. Careful thought must be given to the allocation of time to various tasks. Opportunities for the unproductive use of time abound. Interactions with clients, tradesmen, employers, employees, service people, colleagues in the office, etc., provide avenues for waste and may eat into time needed for budget preparation, travel, handling daily mail, analyzing market research, or preparing leases. The following suggestions are offered as a means of gaining control over the uses of time:

- a. Avoid casual conversation with colleagues and employees which is not in some way related to the work at hand.
- b. Learn to delegate authority.
- c. Don't let the telephone become your taskmaster; know when to be unavailable for calls.

**d. Keep a record of time spent on various routine activities.**

e. Don't vacillate on important decisions; gather the necessary information and act. An unpleasant prospect doesn't get any pleasanter the longer it's avoided, and no amount of information will ever produce an absolute certainty about the outcome of an action. Risk is inherent in all decision making, and avoidance is merely a waste of time.

f. Don't waste time wrestling with priorities. Make a simple task list every day and divide the tasks into rough categories from "urgent" to "least pressing." Then maximize the use of your time by simply doing what is there before you to do, with an eye on the priorities.

## CATEGORIES OF MANAGED PROPERTY

We have discussed the basic categories of property managed by professional property managers — residential, commercial, and industrial. Of residential property it may be said that apartment buildings place the greater demands on the manager, requiring more marketing skills, tenant management skills, and concerns with vacancy levels and rent levels. Condominiums and cooperatives (multi-family residences in which residents have a vested interest in the property and land) involve a more concentrated emphasis on tenant services and building maintenance.

Managers of industrial property frequently are relieved of the necessity of building maintenance (the owner may assume it or the tenant), but must be concerned with detailed marketing surveys, negotiating difficult long-term leases, and joining the appropriate manufacturer to the appropriate investor-owned property. He must be familiar with a wide variety of special needs peculiar to the business of manufacturing, and he must be able to provide prospective tenants with a thoroughly detailed analysis of the relevant social statistics of the area surrounding the physical plant.

Office building management is in a sense city management in miniature, concerned as it is with large populations, transportation needs, utility consumption, safety and security, and such services as building maintenance, janitorial services, and trash collection. Major concerns in office building management are how best to utilize the facility and how to maximize investor profit. Frequently, a manager will be contracted to assist in the design and building of a new office complex, providing projections favoring certain uses to which the building may be put, suggesting appropriate



# 15

## REAL ESTATE INVESTMENTS

### INTRODUCTION

Real estate is a popular means of investment. This chapter will look at what an investor needs to consider, some advantages and disadvantages of investing in real estate, and some ways of investing, determining value of investments, and benefiting from tax advantages for investors.

### INVESTMENT NEEDS

#4  
Investment in real estate requires the participation of an investor, a mortgage lender, the user(s) of the property, and the government. Each of these will affect the feasibility of the investment.

In order to invest wisely in real estate, the would-be investor needs to follow five basic steps: (1) he needs to identify his own objectives and goals, as well as his constraints; (2) he needs to analyze or have analyzed the condition of the market and investment environment; (3) he needs to develop or have developed a financial analysis that forecasts both cash flow and cost of investing; (4) he needs to evaluate the data he has accumulated; and (5) he needs to make a decision about his investment.

An investment that does not satisfy the investor's objectives, goals, and constraints will not be a good investment for him.

Condition of the market means whether or not there is a demand for the investment he plans to make, whether there is a supply of it as well, and what the legal, social, and physical constraints are.

Financial analysis contains many elements beyond the investor's control, such as local employment figures, income, and population. The forecast needed for investing includes probable rents and vacancies, future selling price, estimates of operating expenses during the time he will have

the property, mortgage financing, and all forms of taxation, especially income tax. Federal income tax is one of the most important factors in making decisions about real estate investments.

When he is evaluating data, the investor should consider whether the rate of return in each case will be high enough compensation for the risk he runs.

Once these steps have been considered, the investor can make a decision about the value of this investment for him.

### ADVANTAGES OF INVESTING IN REAL ESTATE

#4  
The person investing in real estate usually does so because he wants a tax shelter, a high rate of return on his money, a hedge against inflation, equity, or leverage.

Real estate provides tax shelter because it often allows the investor to reduce the amount he owes on income tax or to defer payment of certain portions of the income tax due. Such tax advantages as depreciation, capital gains, exchanges, and installment sales benefit the real estate investor.

Since the rate of return on real estate investments is usually higher than the interest rate on a mortgage, investors can finance their investments with borrowed money and be reasonably sure of paying it back with their income from the investment. This is a form of leverage — the effectiveness (power) of using borrowed money to finance an investment and then paying off the loan with income from the investment.

Real estate can act as a hedge against inflation because real estate value, like inflation, keeps going up. Even though the dollar is worth less all the time, the estate is worth more, enough to offset the loss in the dollar's power.